COMPLETE ACCOUNTING COURSE--PART I

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COMPLETE ACCOUNTING COURSE--PART I

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Lecture 1

SINGLE-ENTRY BOOKKEEPING

WORK TO BE DONE IN THE PRACTICE SET

Fred Miller decides to engage in the general automobile supply business. He invests $5,000 cash and leases store and warehouse facilities from Wm. Barnes & Co. for a term of three years commencing January 1, at an annual rental of $600, payable monthly in advance. He plans to keep the following single-entry books:

Day-book (Form 1)
Cash Book (Form 9)
Ledger (Forms 13 and 15)

The personal accounts which follow will be kept during January and should be opened in the ledger as needed. Entries should be made for every transaction--in the day-book if a non-cash transaction, and in the cash book only, if a cash transaction. An item affecting a personal account should be posted as soon as the entry is made.

ACCOUNT	PAGE	ACCOUNT	PAGE
Fred Miller--Capital Account	1	Jno. Smith	7
E. T. Adams	4	C. H. Watt	7
Barnhart & Co.	4	Geo. Wilson	7
W. R. Bell	4	W. B. Winfield	8
Jno. Brown & Co.	5	American Wind-Shield Co.	9
Burnham Brown	5	Auto Truck Co.	9
E. F. Finn	5	Wilson Manufacturing Co.	9
W. T. Jamison	6	Chicago Furniture Co.	10
W. F. Martin	6	New York Auto Supply Co.	10
H. R. Mather	6		

A one-account page should be used for page 1; three-account pages for the remainder. Odd numbers refer to right-hand pages, even numbers to left-hand pages.

SUMMARY OF TRANSACTIONS

JANUARY 2

The capital of $5,000 is paid in. (Debit cash receipts book; post as credit to Fred Miller--Capital account.) Rent of $50 for the month of January is paid to William Barnes & Co. (Is a posting to a personal account necessary here?) Warehouse and office fixtures are purchased from the Chicago Furniture Co. at a cost of $750; invoice payable 30 days from date less 1%.

JANUARY 3

Miscellaneous supplies are bought from the Wilson Manufacturing Co. at a cost of $3,000; terms, 3% cash 10 days, net 30 days. These goods were purchased f. o. b. New York, and freight thereon amounts to $215.50, which is paid in cash.

JANUARY 4

A lot of wind-shields are purchased from the American Wind-Shield Co., net cash 30 days, amount of invoice $1,375. Sale to John Smith on account $125. Cash sales $124.50. Charge sale to W. F. Martin of miscellaneous parts amounting to $97.50; terms 10 days.

JANUARY 5

A shipment of supplies is received today from the New York Auto Supply Co., covered by their invoice dated January 3, due in 30 days, terms net, amounting to $3,123.50. Express charges paid thereon aggregate $17.50. Auto delivery truck purchased from Auto Truck Co. at a cost of $1,750, invoice payable in 30 days. Sold to George Wilson on account, miscellaneous parts $118.40.

JANUARY 6

Bill of Metropolitan Stationery Co. dated January 2 paid in cash, for purchase of day-book, ledger, cash book, and other miscellaneous supplies amounting to $44.75. Fred Miller withdraws cash on personal account, $50 (charge Fred Miller--Capital account). Cash sales $110.50.

JANUARY 8

Charge sale to W. T. Jamison $215. Sundry defective parts are returned to New York Auto Supply Co. for credit, $70.50. Pay salary of bookkeeper and cashier $15.

JANUARY 9

Cash sales $99.10. Received shipment of supplies from Wilson Manufacturing Co. amounting to $4,400; terms, cash 15 days.

JANUARY 10

Ship to C. H. Watt, Peoria, Ill., freight collect, supplies to the value of $187.50, on account. John Smith pays the bill rendered against him on January 4, $125, and deducts 2% discount which is allowed. (Enter the full amount on the cash receipts side and the discount allowed on the cash disbursements side.)

JANUARY 11

Cash sales $110. Insurance premiums paid $48. Proprietor makes additional investment of $6,000 in cash.

JANUARY 12

W. F. Martin settles for invoice dated January 4, by giving a 30-day note for $97.50 with interest at 6%. Shipment of parts to E. F. Finn, Urbana, Ill., on account, $210.

JANUARY 13

Pay Wilson Manufacturing Co.'s bill for $3,000, deducting 3% discount allowed. (Enter the gross amount and discount "in short," extending the net amount, or actual cash paid. This illustrates a second method of handling discounts in single entry.) Charge sale--W. B. Winfield, $195.50. Sundry parts sold to W. T. Jamison on the 8th inst., and billed at $37.50, were returned by him as being defective. Pay American Wind-Shield Co. on account $500.

JANUARY 15

Charge sale of $425 to John Brown & Co. Pay salary of bookkeeper and cashier $15.

JANUARY 16

W. T. Jamison pays the bill dated January 8, after deducting the value of the goods returned on the 13th inst. Cash sales $275.

JANUARY 17

Charge sale of automobile parts to H. R. Mather, $384.50.

JANUARY 18

Cash sales $178.10. Paid for janitor service $12.

JANUARY 19

E. F. Finn pays invoice dated January 12, deducting cartage charge of $10.50, which is allowed. (Make day-book entry for cartage allowance. Discounts may be similarly handled and sometimes preferably so. Two postings--one from the cash book, the other from the day-book--will be made to the personal account.) Charge sale E. T. Adams $187.50.

JANUARY 20

Gas and electric light bills $18.50 paid. Fred Miller withdraws for personal use in merchandise $150. (Debit the capital account.) Cash sales $360.

JANUARY 22

Cash sales $1,801.50.

JANUARY 23

Shipments to Burnham Brown on account $1,315. Cash sales $1,405.

JANUARY 24

Pay American Wind-Shield Co. $500 on account; also Wilson Manufacturing Co.'s invoice dated January 9, $4,400.

JANUARY 26

Printing bill $23.75 paid today. Cash sales $1,187.60.

JANUARY 27

Fred Miller withdraws for personal use, in cash, $50. Cash sales $1,218.10.

JANUARY 29

Burnham Brown pays $200 on account of invoice rendered January 23. Pay New York Auto Supply Co. $1,000 on account.

JANUARY 30

C. H. Watt pays his invoice of January 10 and at the same time orders additional goods amounting to $110. The order is shipped.

1. Post the transactions for the month of January from the day-book and cash book to the ledger accounts where necessary. After the posting is completed, prepare a statement of assets and liabilities at January 31 from the information contained in the books, and the following:

Inventory of merchandise on hand $2,197.50; warehouse and office fixtures $750; auto delivery truck $1,750; note receivable $97.50.

2. What is the amount of profit or loss for the month of January? Prepare a statement showing how same is determined.

Having ascertained the net profit for January, make an entry in the day-book recording the profits earned, and post the same to Fred Miller's capital account. The balance of the capital account should now be the same as the net worth appearing in the statement of assets and liabilities.

SINGLE-ENTRY BOOKKEEPING

Definition--Bookkeeping in general may be defined as the recording of financial transactions in books of account. Single entry is a term used to describe those methods of recording business transactions which do not involve complete double entry, and is defined by various authorities as follows:

"As the term 'single entry' is employed in text-books and referred to in examination questions, it usually means the ledger accounts of customers and trade creditors, together with the source book or books from which items comprising these accounts are posted." (Belding)

"The fundamental distinction is that theoretically single entry has none but personal accounts." (Cole)

"Books kept upon a partial or incomplete system of bookkeeping are said to be kept by single entry." (Lisle)

"Single-entry bookkeeping is in its essence the recording of personal debts only." (McFarland & Rossheim)

Books Kept--The books usually kept in a single-entry system are (1) day-book, (2) cash book, and (3) ledger. A sales book, purchase record, note record, and other books may also be used for memorandum purposes.

1. Day-book. Form 1 illustrates the common type of day-book. Columns are ruled for date, account, explanation, folio, details, and total. Its form is not restricted. The two money columns may be used for "debit" and "credit" items respectively, while the date may be placed on a line immediately above the description of the transaction.

The day-book has nearly disappeared from modern bookkeeping practice. It was formerly the custom to attach the utmost importance to this record, even in double-entry bookkeeping. All entries affecting the accounts of a business had to be entered here in great detail; it was recognized by the courts as evidence against debtors and more trustworthy than a ledger. It is used no longer except in single-entry bookkeeping.

While in single entry every transaction of a business is customarily recorded in the day-book, only those items affecting personal accounts are posted to the ledger.

2. Cash Book. A cash book, if kept in single entry, differs in no way from the ordinary cash book. The left-hand page is the "debit" side (cash receipts) and the right-hand page the "credit side" (cash payments). As a general rule the cash book is used as a posting medium, but in some cases all cash entries are made in the day-book and posted thence into the ledger if they affect personal accounts. Often the cash book is dispensed with altogether, a cash register and informal memoranda taking its place. When the customer pays an account, the amount paid is recorded and footed in the cash register on a separate set of wheels by depressing a key labeled "On Acc." The daily total thereof should agree with the amounts which appear on the stubs of the receipt book. Accounts to be credited are then recorded in the day-book from the receipt book and postings made. Amounts paid to creditors may be similarly abstracted from the stubs of the check book and then entered in the day-book and posted to the ledger. If there is no cash register, or if payments to creditors are sometimes made in cash instead of by check, it is best to keep a cash book, the balance of which will at any time show the

amount of cash on hand and in the bank. Transactions with the bank may appear in the cash book by adding additional columns thereto; but in a small business the information appearing on the check stubs is usually sufficient.

3. Ledger. As already indicated, the ledger contains accounts with persons only--debtors and creditors, and often only debtors. Many varieties of single-entry ledgers may be found. A simple rule for debiting and crediting such accounts is "debit for value given by the business and credit for value received by the business."

In addition to personal accounts with debtors and creditors, the proprietor may keep an account with himself, showing original investment, additions, and withdrawals.

METHOD OF OPENING A SINGLE-ENTRY SET OF BOOKS

Assume that John Brown commences business on January 1, 1916, with the following assets on hand: store and lot $2,000; merchandise $850; cash $150; $500 due from William Smith. Also John Brown owes James Green for merchandise purchased to the extent of $200. The following entry would be made in the day-book:

DATE	LEDGER FOLIO	ACCOUNT		DETAIL COLUMN	TOTAL COLUMN
1916					
Jan. 1	x	John Brown--Investment	Cr.		$3,300.00
		For capital this day invested, details as follows:			
		Store and Lot		$2,000.00	
		Merchandise		850.00	
		Cash		150.00	
		William Smith--Account Receivable		500.00	
		Total Assets		$3,500.00	
		Deduct:			
		James Green--Account Payable		200.00	
	x	William Smith	Dr.		500.00
		For account due me, as above			
	x	James Green	Cr.		200.00
		For amount due him, as above			

The "Dr." or "Cr." notifies the bookkeeper that the item so designated is to be posted as a "debit" or "credit" to the account specified.

METHOD OF CLOSING BOOKS AND PREPARATION OF FINANCIAL STATEMENTS AT THE CLOSE OF A FISCAL PERIOD

Continuing the illustration in the preceding paragraph, assume that on December 31, 1916, John Brown took an inventory of his merchandise on hand and found it to be $750, valued at cost. The total cash in his cash register amounted to $50, while the last stub in his check book showed his bank balance to be $200. His accounts receivable according to his ledger totalled $1,000,

while he owed on accounts payable $600. During the year he added $1,000 to his investment in the business and withdrew in cash $1,200. It is desired to ascertain his financial position at December 31, 1916, and his net profits for the year. His assets and liabilities at December 31, 1916, would therefore appear as follows:

JOHN BROWN
STATEMENT OF ASSETS AND LIABILITIES
DECEMBER 31, 1916

ASSETS		LIABILITIES AND CAPITAL	
Store and Lot	$2,000.00	Accounts Payable	$ 600.00
Merchandise Inventory	750.00	Balance--Net Worth, December 31, 1916	3,400.00
Accounts Receivable	1,000.00		
Cash in Bank and on Hand	250.00		
Total Assets	$4,000.00	Total Liabilities and Capital	$4,000.00

The net profits would be ascertained by comparing the net worth at the beginning and end of the period and taking into account additions of capital and withdrawals, thus:

JOHN BROWN
STATEMENT OF NET PROFITS
YEAR ENDING DECEMBER 31, 1916

Net Worth December 31, 1916	$3,400.00
DEDUCT--Net Worth January 1, 1916	3,300.00
Net Increase in Investment	$ 100.00
ADD--Withdrawals during year	1,200.00
	$1,300.00
DEDUCT--Additional Capital Invested	1,000.00
Net Profits for year	$ 300.00

This method of arriving at net profits is called the "asset and liability" method, in contrast to the "profit and loss" method which will be illustrated later. The formula for obtaining profits in this manner may be stated algebraically as follows:

```
           (Assets at     )    (Assets at begin-)
(Net Prof-) (end of period)    (ning of period  )    (With-   )   (Additional)
(it for a )=(    less      )LESS(      less      )PLUS(drawals)LESS(investment)
(given    ) (Liabilities   )    (Liabilities at  )    (during )   (during    )
(period   ) (at end of     )    (beginning of    )    (period )   (period    )
            (period        )    (period          )
```

Stated in another way the NET WORTH is:

Increased by	And decreased by
(a) Profit arising from operations	(a) Losses sustained from operations
(b) Contribution of additional capital by owners	(b) Withdrawal of capital by owners

ADVANTAGES AND DISADVANTAGES OF SINGLE ENTRY

The limitations of single entry may be pointed out more easily than its merits. In estate accounting, or in small retail businesses where the chief bookkeeping need is to show receipts and disbursements and the status of personal accounts rather than the condition of all the assets and the causes of changes therein, incomplete double entry may be sufficient. But under present business conditions even the small merchant feels the need of knowing his financial position at frequent intervals, and what may be more important, the sources of his profit. The data required for successful operation under increased competition and standardization can be obtained only from accurate and analytical records, and single-entry records of the kind in general use do not meet these requirements.

Three leading objections to single entry may be stated as follows:

1. A record of accounts with persons only is insufficient. An analysis of various elements in a business can be secured with greater facility by a system of detailed accounts which increase in number and importance with the size of the business.

2. While the net profit or loss for the period may be obtained by single entry (or by keeping no records at all), no analysis thereof is possible ordinarily without the introduction of a columnar cash book and other records which would be at least as difficult to operate as a set of simple double-entry records.

3. No check on the clerical accuracy of the posting can be made under the methods generally in use. A sale to a customer entered in the day-book might never be posted to a customer's account. But in double entry such an omission is unlikely because of the check on clerical accuracy obtained through the trial balance.

REFERENCES:

Belding, pages 149-152
Klein, Chapter IV
Lisle, pages 42-44
MacFarland and Rossheim, pages 14-18

COMPLETE ACCOUNTING COURSE--PART I

Lecture 2

CHANGING BOOKS FROM SINGLE ENTRY TO DOUBLE ENTRY
DOUBLE-ENTRY BOOKKEEPING

Problem 1

The assets and liabilities of the firm of Higgins & Wilcox at June 30, 1916, were as follows: land $5,000; buildings $12,000; machinery $18,000; other equipment $4,000; inventory of merchandise $29,000; uncollected customers' accounts $18,000; unpaid invoices for purchases of materials $7,500; notes receivable $3,500; bank loans $5,000; capital account--Higgins $37,000; and capital account--Wilcox $40,000.

The foregoing information was abstracted from the single-entry books kept and other records.

On June 30, 1917, the firm's bookkeeper compiled the following data from the books and from information furnished by certain memorandum records kept by Walter Higgins--one of the partners. Warehouse and office furniture and fixtures $1,500; land $6,500; machinery $19,500; buildings $12,000; other equipment $6,000; inventory of merchandise $35,000; uncollected customers' accounts $17,000; accounts payable $18,500; notes receivable $5,500; bank loans $4,000; withdrawals by Higgins $2,000; and by Wilcox $3,000.

The partners desired the bookkeeper to furnish the following:

(a) Statement of assets and liabilities at June 30, 1917.
(b) Statement of profit or loss for the year ending June 30, 1917.
(c) Statement of partners' capital accounts at June 30, 1917.

The partnership agreement provides that profits and losses are to be divided on the basis of 1/3 to Higgins and 2/3 to Wilcox.

Also prepare journal entries necessary to open the books on a double-entry basis.

MISCELLANEOUS QUESTIONS

Question 1--Suggest a method of proving the correctness of postings in single-entry books.

Question 2--Following out the illustration given in I-1-6, suppose John Brown has kept an account with himself, as proprietor. Prepare the account as it would appear on December 31, showing original investment, withdrawals, and profits for the year.

Question 3--Write a simple explanation of the terms "debit" and "credit" so that they are intelligible to a person not familiar with the handling of accounts.

Question 4--Explain the following terms:

(a) Assets
(b) Liabilities
(c) Net Worth
(d) Entry
(e) Bookkeeping
(f) Accounting

WORK TO BE DONE IN THE PRACTICE SET

From the statement of assets and liabilities prepared from the books and other records of Fred Miller, draft the journal entries required to be made in order to open his books on the double-entry system. Where the accounts already appear in the ledger, note after such items in the journal entry "already posted," posting the balance of the items to the ledger.

The books of account to be kept by Fred Miller during February are:

Journal (Form 2)
Cash Book (Form 9)
Ledger (Forms 13, 14, and 15); the ledger pages opened in the January transactions to be retained,and new accounts opened as shown below.

ACCOUNT	PAGE	ACCOUNT	PAGE
Fred Miller--Drawing Account	2	Salaries	13
Warehouse and Office Fixtures	3	Rent	13
Auto Delivery Truck	3	Stationery and Supplies	13
Merchandise Inventory	3	General Expense	14
Notes Receivable	8	Interests	14
Cash	8	Discount on Sales	14
Merchandise	11-12	Discount on Purchases	15
		Profit and Loss	15

Pages 2 and 11-12 are one-account pages; page 15 is a two-account page; the others are three-account pages.

The merchandise inventory will appear in the Merchandise Inventory account; purchases, sales, returns, and allowances in the Merchandise account; discounts received and given in the Discount accounts.

Every transaction must be "journalized," i. e., a debit for every credit must appear either in the cash book or general journal. Postings to the ledger should be made as soon as the entry is completed. The debits and credits to the cash account will be made only at the end of the month, in total, and entries in the cash book should be so made that it will be possible to show the total receipts and total disbursements on February 28. It will be noticed that the sheets for cash receipts and cash disbursements each contain two columns. The first column on either page should be used for current receipts and disbursements respectively; while in the last column should be entered balances brought forward and totals for the month.

Solution to Assignment I-1-1

FINANCIAL STATEMENTS OF FRED MILLER AT JANUARY 31

FRED MILLER
STATEMENT OF ASSETS AND LIABILITIES
JANUARY 31, 19--

ASSETS		LIABILITIES AND CAPITAL	
Warehouse and Office Fixtures	$ 750.00	Accounts Payable	$ 4,928.00
Auto Delivery Truck	1,750.00	Balance--Net Worth, January 31, 19--	11,289.30
Inventory of Merchandise	2,197.50		
Accounts Receivable	2,535.90		
Note Receivable	97.50		
Cash	8,886.40		
Total Assets	$16,217.30	Total Liab. & Capital	$16,217.30

FRED MILLER
STATEMENT OF PROFIT
MONTH ENDING JANUARY 31, 19--

Net Worth January 31, per statement		$11,289.30
Deduct--Investments during January:		
January 1	$5,000.00	
January 11	6,000.00	11,000.00
Increase in Net Worth		$ 289.30
Add--Withdrawals during month		250.00
Net Profit for month		$ 539.30

SCHEDULE OF ACCOUNTS RECEIVABLE
At January 31, 19--

E. T. Adams	$ 187.50
Jno. Brown & Co.	425.00
Burnham Brown	1,115.00
H. R. Mather	384.50
C. H. Watt	110.00
Geo. Wilson	118.40
W. B. Winfield	195.50
Total	$2,535.90

SCHEDULE OF ACCOUNTS PAYABLE
At January 31, 19--

American Wind-Shield Co.	$ 375.00
Auto Truck Co.	1,750.00
Chicago Furniture Co.	750.00
New York Auto Supply Co.	2,053.00
Total	$4,928.00

METHOD OF CHANGING A SET OF BOOKS FROM A SINGLE-ENTRY TO A DOUBLE-ENTRY BASIS

In single-entry accounts with persons only are usually kept. In order to change to double entry it will be necessary, therefore, to set up those assets and liability accounts not already appearing on the ledger. To accomplish this a journal entry should be made containing all the items in the statement of assets and liabilities. If a new ledger is opened all items will be posted. If the old ledger is retained a comment should be made following the accounts receivable and payable, that they are already posted. Referring to the illustration in I-1-6, the following entry will show how John Brown's books may be put upon a double-entry basis. The day-book is transformed into a journal by using the "details" column as a "debit" column and the "total" column as a "credit" column:

LEDGER FOLIO	ACCOUNT	DEBIT	CREDIT
x	Store and lot	$2,000.00	
x	Merchandise Inventory	750.00	
x	Cash (to be entered also in cash book)	250.00	
	William Smith (already posted)	1,000.00	
	To--James Green (already posted)		$ 600.00
	John Brown--Capital Account		3,400.00

If the proprietor's capital account has been kept in the single-entry ledger, it should be treated in the same manner as accounts receivable and payable.

DOUBLE-ENTRY BOOKKEEPING

DEFINITION--Double-entry bookkeeping was first made known in a mathematical treatise published in 1494 by Luca Paciolo. A definition satisfactory to all has not been formulated as yet, but the following quotations are of interest:

"Scientific bookkeeping, known as the double-entry method, is the art of classifying and recording business transactions in chronological sequence, and in such manner as to show the effects which all business transactions and necessary bookkeeping adjustments have upon the assets, liabilities, capital, surplus, revenue, and expenses of the business." (Bentley)

"Bookkeeping is the art of recording business transactions with the view of having a permanent record of them and of showing their effect upon wealth. Each individual business transaction has a two-fold effect, and it may be useful to look on this effect as having a positive and also a negative character. . . . As bookkeeping records this two-fold effect, it is spoken of as bookkeeping by double entry." (Lisle)

"The record of a business transaction by which we indicate both the giver and the receiver of value is called 'double entry.' " (Belding)

Double-entry bookkeeping "is based on the fact that every transaction involves a transfer of property or its equivalent from one person to another, the terms 'property' and 'person' being used in the widest possible sense." (Dickinson)

WHEN TO DEBIT AND WHEN TO CREDIT--The following rule is given for "journalizing" (entry-making):

DEBIT FOR	CREDIT FOR
1. An increase of assets	1. A decrease of assets
2. A decrease of liabilities	2. An increase of liabilities
3. A decrease of proprietorship (wages, rent, and other expenses)	3. An increase of proprietorship (i. e., sales and other income)

With the above rule in mind, the student should review the transactions in Lecture 1, explaining the debit and credit involved in each case.

BOOKS KEPT--All books used in double entry may be classified either as journals or ledgers. The journals are called BOOKS OF ORIGINAL ENTRY and their function is to record transactions chronologically and in sufficient detail so that the subject matter may be clearly identified at any time. Ledgers are called BOOKS OF FINAL ENTRY and classify transactions according to a predetermined schedule of accounts. The operation of transferring items from a journal to a ledger is termed POSTING. All entries in a journal must be posted, either separately or in total, and, conversely, no item may appear in a ledger that has not been posted from a journal.

The term "journal" generally refers to the "general journal," i. e., the book of original entry which receives entries which cannot be put elsewhere. The ordinary cash book is sometimes called a "cash journal," but the latter term may also refer to a combined cash book and general journal.

REFERENCES:

Cole, Chapter II
Gilman, Chapter I
Klein, Chapter I
Sprague, Chapters IV-V

COMPLETE ACCOUNTING COURSE--PART I

Lecture 3

THE ACCOUNT

MISCELLANEOUS QUESTIONS

Question 5--What is your understanding of the terms Capital Assets, Current Assets, Capital Liabilities, Current Liabilities?

Question 6--Indicate which of the accounts of Fred Miller would fall under the classification of Real, Nominal, Personal, Impersonal, Asset, Liability, Income, and Expense accounts.

Question 7--An account current with the C D Co. is kept on the A B Co.'s books. Transactions during the month of September are as follows: (1) credit balance September 1, $1,856; (2) purchase September 3 from the C D Co. $3,450; (3) returned purchases September 5 on shipment of September 3 amounting to $306; (4) sale to C D Co. September 16, $1,670; (5) allowance September 20 to C D Co. on account of sale made September 16, $320; (6) check sent to C D Co. September 25, $2,000. Prepare the account as it would appear on the A B Co.'s books, bringing down the balance on October 1. Where should this account appear on a statement of assets and liabilities?

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

FEBRUARY 1

Rent of $50 for February paid. Purchased from the American Wind-Shield Co., much below the current market prices, a lot of miscellaneous goods of an aggregate value of $8,000, payable in 5 days less 2% discount. Geo. Wilson purchases miscellaneous auto supplies, terms net 30 days--$230. Cash sales $180.50.

FEBRUARY 2

John Brown & Co. pay invoice of January 5, $425. Paid for auto truck, $1,750, to the Auto Truck Company. Miscellaneous goods sold to E. T. Adams, terms net 30 days, $75. Cash sales $184.

FEBRUARY 3

Pay Chicago Furniture Co. $750 less 1%. Burnham Brown pays the balance of $1,115 due on his account, and an additional shipment of goods valued at $310 is made to him.

FEBRUARY 5

Deduction of $75 allowed by the American Wind-Shield Co. for defective goods returned. The balance of the invoice of January 4, amounting to $300, remitted in cash. Paid to the New York Auto Supply Co. $2,053 in full settlement of account. Cash sales $215.60. Salary of cashier and bookkeeper paid, $15.

FEBRUARY 6

H. R. Mather remits $380, having been allowed $4.50 for freight which he paid. Cash sales $298. Purchases from the New York Auto Supply Co., terms 2% 10 days, miscellaneous goods, $1,113.60. Pay bill of the American Wind-Shield Co., $8,000 less discount.

FEBRUARY 7

The following account is collected: W. B. Winfield $195.50. Charge sale to C. H. Watt $325.

FEBRUARY 8

Sundry office expenses, carfare, etc., paid in cash, $11.30.

FEBRUARY 9

Purchase tires and other supplies from New York Auto Supply Co., $1,350, terms net cash in 30 days.

FEBRUARY 10

Cash sales $194.50. Sundry warehouse charges $11.80, paid in cash (charge General Expense).

FEBRUARY 12

W. F. Martin pays his note of January 12, with interest 30 days at 6%. George Wilson pays invoice of $118.40, deducting $20 for defective materials returned. Bookkeeper's salary $15 paid.

FEBRUARY 13

Sale to W. B. Winfield, terms 30 days net, $398. Office supplies purchased for cash $18.40 (charge Stationery and Supplies).

FEBRUARY 14

Charge sale to W. R. Bell $1,810, terms 2% cash in ten days.

FEBRUARY 15

Electric light and gas bills paid in cash $19.50.

THE ACCOUNT

DEFINITION--An account is "an entry or group of entries, either debits or credits or a combination of both, under a specific or descriptive heading, exhibiting the history and results of the transactions pertaining thereto." (From report of Committee on Terminology, American Association of Certified Public Accountants.) The account may be known by its "specific or descriptive heading," that is, by a title such as "merchandise," "salaries," or by a number or symbol. Accounts are known by their numbers in many large businesses for the purpose of convenient reference. (See classification of accounts for various public utilities prescribed by the Interstate Commerce Commission.) Mnemonic symbols, that is, symbols that suggest the name of the account (AP, "Administrative Postage") are sometimes used. (See Cole, "Cost Accounting for Institutions.")

CLASSIFICATIONS OF ACCOUNTS--For the purpose of securing uniform results and control over the accounts of public utilities, the Interstate Commerce Commission and many state public utility commissions have prescribed classifications of accounts, usually in great detail. The Bureau of Business Research at Harvard has suggested classifications for retail shoe dealers and retail grocers together with a system of reports which have worked out successfully. Whether or not a uniform system of accounts is to be followed, a definite classification should be determined upon before the books of a concern are opened, due provision being made for the possible future expansion of the business. The following is a simple classification of accounts of a small retail business together with a system of numbering that may be followed:

	ASSETS		EXPENSE
101	Land	901	Salaries
102	Buildings	902	Rent
103	Fixtures	903	Heat and Light
201	Inventory of Merchandise	904	Advertising
202	Accounts Receivable	905	Stationery and Printing
203	Notes Receivable	906	Miscellaneous Expense
204	Cash	907	Interest Paid
	LIABILITIES		KEY TO CLASSIFICATION
401	Proprietor's Capital Account	100	Capital Assets
402	Proprietor's Drawing Account	200	Current Assets
501	Mortgage Payable	300	
601	Accounts Payable	400	Proprietor's Accounts
602	Notes Payable	500	Long-term Liabilities
		600	Current Liabilities
	INCOME	700	
801	Sales	800	Income
802	Interest Received	900	Expense

The classification being determined upon, the order in which the accounts appear in the ledger is immaterial. In a small business where the accounts are few, an alphabetical arrangement might be found convenient; in a larger business the order as illustrated on this page might be followed, especially if the accounts bear numbers.

DIVISION OF ACCOUNTS--Accounts are generally divided into the following classes:

```
                         (Asset     )
                         (          )Personal
                 (Real   (          )   and
                 (       (          )Impersonal
                 (       (Liability)
        Accounts(
                 (       (Expense   )
                 (       (          )
                 (Nominal(          )Impersonal
                         (          )   only
                         (Income    )
```

REAL accounts are those that express the financial condition of the business and consist of asset and liability accounts. They are also called FINANCIAL accounts.

NOMINAL accounts are those that show the results from operation of a business, i. e., the income and expense accounts, and are sometimes referred to as ECONOMIC accounts.

MIXED accounts are those which contain both real and nominal elements. The commonest example of a mixed account is the old-style merchandise account.

An ACCOUNT CURRENT or CURRENT ACCOUNT is an account which contains "a running record of current financial transactions between two parties who may, through the growth of their account, become debtor and creditor alternately." That is, the account current may be either an asset or liability, according to whether the balance is a debit or credit.

MERCHANDISE ACCOUNT--In a trading business the merchandise account shows the profit or loss from the purchase and sale of merchandise. When kept as a single account it generally contains the following items:

MERCHANDISE ACCOUNT

DEBIT	CREDIT
With inventory at beginning of period.	With sales of merchandise during period.
With purchases of merchandise during period.	With return purchases.
With freight, cartage and other charges on purchases and sales.	With allowances received on purchases.
With return sales.	With inventory at close of period.
With allowances on sales.	

The balance of this account, if a credit balance, shows the profit on merchandise sales before the expenses of the business are deducted, and is known as the GROSS PROFIT; if a debit balance it represents the GROSS LOSS.

DIVISION OF MERCHANDISE ACCOUNT--Except in small businesses, the merchandise account as described above is rarely found. Instead, the various elements relating to purchases, sales, return purchases, return sales, allowances on purchases, allowances on sales, etc., are segregated in separate accounts. Such accounts would appear as follows, with further subdivision as the business increases in size:

PURCHASES ACCOUNT

DEBIT	CREDIT
With purchases of merchandise at cost. With freight, cartage, and other charges thereon.	With return purchases. With allowances on purchases.

The balance of this account will be a debit and is closed into the Trading account.

SALES ACCOUNT

DEBIT	CREDIT
With freight-out and other charges on sales. With return sales. With allowances on sales.	With sales of merchandise at selling price.

The balance of this account will be a credit and is closed into the Trading account.

INVENTORY ACCOUNT

DEBIT	CREDIT
With inventory of merchandise at the close of fiscal period.	With an amount equal to the inventory at the close of the previous fiscal period already standing as a debit to this account.

The balance of this account is an asset and will be carried down as a debit balance.

TRADING ACCOUNT

DEBIT	CREDIT
With balance of Purchases account at close of fiscal period. With inventory at the end of the previous fiscal period.	With balance of Sales account at close of fiscal period. With inventory at close of present fiscal period.

The balance of this account, if a credit, shows the GROSS PROFIT from trading; if a debit, the GROSS LOSS from trading. The balance is carried into Profit and Loss account.

REFERENCES:
Belding, pages 12-40
Gilman, Chapter II
Sprague, Chapters I, II, III, Appendix B

COMPLETE ACCOUNTING COURSE--PART I

Lecture 4

OPERATION OF DOUBLE ENTRY

MISCELLANEOUS QUESTIONS

Question 8--What do you understand by a "system of internal check?" Describe some good or bad feature of a system of internal check.

Question 9--Record the five transactions enumerated in Question 7, Lecture 3, in journal-entry form, giving full explanations.

Question 10--In taking off a trial balance from a ledger you find that the total debits equal the total credits. Do you regard this as conclusive proof that the books are in balance? If the difference is small, is it desirable to write it off?

Question 11--In closing the cash book at the end of each month, what steps must be taken? What is the object of opening a cash account in the ledger?

Question 12--What is the function of a ledger?

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

FEBRUARY 16

Fred Miller withdraws for personal use in cash $150 (charge Drawing account).

FEBRUARY 17

Pay New York Auto Supply Co. bill of February 6, deducting discount of 2%. Cash sales $98.40.

FEBRUARY 19

Office and other supplies purchased for cash, $35.35. Purchase from the Wilson Manufacturing Co., a lot of goods for $1,600, terms 2% cash 15 days. Pay salary of bookkeeper $15.

FEBRUARY 20

E. T. Adams pays $50 on account of invoice dated February 2. Ship to Barnhart & Co., tires and other supplies $305.75, terms 2% cash 10 days.

FEBRUARY 21

Fred Miller withdraws for personal use, in cash, $175. W. R. Bell pays invoice rendered against him on February 14, deducting $36.20 in respect of discount.

FEBRUARY 23

Cash sales $391.50. Purchase additional fixtures from Chicago Furniture Co., $500, invoice payable in 30 days.

FEBRUARY 26

Express charges of $2.25 paid on goods returned by Barnhart & Co.; and they are allowed $105.75 on the goods, which are defective. Petty office expenses paid, $12.60. Fred Miller withdraws for personal use $100 in merchandise.

FEBRUARY 27

Expenses $21.35 paid in cash in connection with up-keep of motor truck. Ship to Burnham Brown a wind-shield and other supplies $184.50, terms 2% cash 10 days.

FEBRUARY 28

Burnham Brown remits $490.81 and is further allowed a discount of $3.69. Pay warehouse and other employees for services rendered during the month of February, $395.50 (charge Salaries account). C. H. Watt and W. R. Winfield remit the balance of their accounts.

Close the cash book and post the total cash receipts and the total cash disbursements to the ledger cash account. All other items having been posted, draw off and submit a trial balance of the general ledger.

Solution to Problem 1 — Exhibit A

HIGGINS AND WILCOX
STATEMENT OF ASSETS AND LIABILITIES, JUNE 30, 1916

ASSETS		LIABILITIES		
Land	$ 5,000.00	Accounts Payable		$ 7,500.00
Buildings	12,000.00	Bank Loans		5,000.00
Machinery	18,000.00			
Other Equipment	4,000.00	Total Liabilities		$12,500.00
Inventory of Merchandise	29,000.00	Net Worth or Capital:		
Customers' Accounts	18,000.00	Higgins	$37,000.00	
Notes Receivable	3,500.00	Wilcox	40,000.00	77,000.00
	$89,500.00			$89,500.00

A year later the following statement was prepared:

HIGGINS AND WILCOX
STATEMENT OF ASSETS AND LIABILITIES, JUNE 30, 1917

ASSETS		LIABILITIES	
Land	$ 6,500.00	Accounts Payable	$18,500.00
Machinery	19,500.00	Bank Loans	4,000.00
Buildings	12,000.00		
Warehouse and Office Furniture and Fixtures	1,500.00	Total Liabilities	$22,500.00
Other Equipment	6,000.00	Net Worth, June 30, 1917	80,500.00
Inventory of Merchandise	35,000.00		
Customers' Accounts	17,000.00		
Notes Receivable	5,500.00		
	$103,000.00		$103,000.00

HIGGINS AND WILCOX
STATEMENT OF PROFITS
YEAR ENDING JUNE 30, 1917

Exhibit B

Net Worth at June 30, 1917		$80,500.00
Deduct--Net Worth at June 30, 1916		77,000.00
Increase in Net Worth		$ 3,500.00
Add--Withdrawals by Partners:		
Higgins	$2,000.00	
Wilcox	3,000.00	5,000.00
Balance--Profit for the year ending June 30, 1917		$8,500.00
WHICH IS DIVIDED AS FOLLOWS:		
Higgins 1/3	$2,833.33	
Wilcox 2/3	5,666.67	
(As above)	$8,500.00	

HIGGINS AND WILCOX
CAPITAL ACCOUNTS, JUNE 30, 1917

Exhibit C

	HIGGINS	WILCOX	TOGETHER
Balance as at June 30, 1916	$37,000.00	$40,000.00	$77,000.00
Add--Profits, year ending June 30, 1917	2,833.33	5,666.67	8,500.00
	$39,833.33	$45,666.67	$85,500.00
Deduct--Withdrawals	2,000.00	3,000.00	5,000.00
Balance at June 30, 1917	$37,833.33	$42,666.67	$80,500.00

Journal Entry to Open Books of
HIGGINS AND WILCOX
on double entry system

Land	$ 6,500.00	
Machinery	19,500.00	
Buildings	12,000.00	
Warehouse and Office Furniture & Fixtures	1,500.00	
Other Equipment	6,000.00	
Inventory of Merchandise	35,000.00	
Customers' Accounts (already posted)	17,000.00	
Notes Receivable	5,500.00	
To--Accounts Payable (already posted)		$18,500.00
Bank Loans		4,000.00
Higgins--Capital Account		37,833.33
Wilcox--Capital Account		42,666.67

ANSWERS TO QUESTIONS

<u>Answer to Question 1</u>--Two special money columns may be provided in both day-book and cash book, the first to contain items to be posted to the debit of ledger accounts, the second to contain items to be posted to the credit of ledger accounts. The formula then would be:

```
(Previous )                                                 (Total of) (Total of)
(net total)+(Daybook)-(Daybook)+(Cash book)-(Cash book)=(debit    )-(credit   )
(of ledger) (debits ) (credits) (debits   ) (credits  ) (ledger   ) (ledger   )
(accounts)                                              (accounts) (accounts)
```

OR IF THE CREDITS EXCEED THE DEBITS:

```
(Previous )                                                 (Total of) (Total of)
(net total)+(Daybook)-(Daybook)+(Cash book)-(Cash book)=(credit   )-(debit    )
(of ledger) (credits) (debits ) (credits  ) (debits   ) (ledger   ) (ledger   )
(accounts)                                              (accounts) (accounts)
```

Unless some such method is followed, a proof of the postings would require a complete checking either from the cash book and day-book into the ledger, or from the ledger into the day-book and cash book.

Answer to Question 2--

JOHN BROWN--CAPITAL ACCOUNT

DATE	PARTICULARS	FOLIO	AMOUNT	DATE	PARTICULARS	FOLIO	AMOUNT
1916				1916			
Dec. 1	Withdrawals	C85	$1,200	Jan. 1	Investment	C1	$3,300
				Sept. 1	Additional Investment	C56	1,000
Dec. 31	Balance (in red)		3,400	Dec. 31	Net Profit for year	DB42	300
			$4,600				$4,600
				1917			
				Jan. 1	Balance		$3,400

If the account had been kept as above in the single-entry set, it would be retained on the double-entry books, making necessary only the writing of the words "already posted" after the item in the opening journal entry.

Answer to Question 3--It has been shown (Lecture 2) that every business transaction may be looked at from two viewpoints: (1) either (a) an increase of assets, (b) a decrease of liabilities, or (c) a decrease of proprietorship; and (2) either (a) decrease of assets, (b) an increase of liabilities, or (c) an increase of proprietorship. It follows, therefore, that there are nine different kinds of transactions according to this analysis. Group 1 is called "debit," and Group 2 is called "credit." It is necessary for one not familiar with accounts to examine each transaction presented on some such basis until the matter of "what to debit and what to credit" becomes second nature.

An understanding of the "accountability" theory is also helpful. (See Cole, Chapter II.)

Answer to Question 4--

(a) ASSETS are the properties (real or personal, tangible or intangible) of a business or person, generally expressed in accounting in terms of money value.

(b) LIABILITIES are moneys owing by a business or person to others. The term sometimes includes the proprietor's interest in the business.

(c) The NET WORTH of a business is the difference between its total assets and its liabilities (to outsiders). It is synonymous here with PROPRIETORSHIP, NET CAPITAL INVESTMENT, etc.

(d) BOOKKEEPING is the art of keeping chronological and systematic records of business transactions.

(e) "ACCOUNTING is the science which treats of the systematic record, compilation and presentation in a comprehensive manner of the financial operations of a business." (Committee on Accounting Terminology, American Association of Public Accountants.)

OPERATION OF DOUBLE ENTRY

SYSTEM OF INTERNAL CHECK--A system of internal check resembles in principle the "system of checks" imposed by the Constitution on the Federal government. In a small business employing a combined bookkeeper and cashier no such system of checks is possible. But in a corporation with a large number of employees engaged on the bookkeeping records, a system of internal check is most necessary and serves four main purposes:

1. To facilitate the prompt handling of accounts.
2. To put responsibility on the proper officials.
3. To decrease chances of error.
4. To decrease chances of fraud.

The details of what a system of internal check should embrace are outlined in Montgomery's Auditing, pages 53-58.

JOURNALIZING--Too much emphasis cannot be put on the method of making entries in books of original entry. Review the principles laid down in the study of bookkeeping. Attention should be paid to the following points:

1. The form of the book of original entry (cash book, sales book, general journal, etc.) must be such that sufficient space is allowed for full record of the entry.

2. Accounts to be credited and debited must be clearly indicated so that the ledger-keeper need have no doubt of where to post.

3. Authorization for the entry should be shown where necessary, this being effected in some cases by the proper official initialing the entry.

4. A JOURNAL VOUCHER is recommended for the general journal where the latter receives only the more unusual entries and where the entries are relatively few. This voucher should be passed upon and approved before the entry is made. It has the advantage of providing a folder in which papers, etc., relating to the entry may be filed.

POSTING--Care should be taken that the correct reference is given when postings are made both

1. In the ledger to record the page number and the journal in which the entry appears; and

2. In the journal to record the number of the account to which the entry is posted.

Where a large number of entries are made daily, it is of importance to keep a constant check on the accuracy of the postings in addition to taking the monthly trial balance. There are several methods of verifying the daily entries.

TRIAL BALANCE--A trial balance is a statement of all the "open" accounts (accounts the sum of whose debits and credits are not equal) in a ledger, showing in two parallel money columns either the total of the debit side and the total of the credit side of each account, or the difference between the debit and credit sides of each account. In a trial balance taken from a general ledger, the total debits should equal the total credits if the posting has been done correctly.

The purpose of the trial balance is two-fold:

1. To prove that the ledger is in balance.
2. To be used as a basis for preparing financial statements.

If the totals of the trial balance are correct, such evidence should not be taken to mean that no errors have been made. Postings to wrong accounts and offsetting errors will not be detected.

ERRORS--Errors in the bookkeeping records caused by mistake, ignorance, or fraud may be classified under:

1. ERRORS OF PRINCIPLE. The most important error falling under this head is the charging of expenses to asset accounts or vice versa. The result in the first instance would be an overstating, and in the latter, an understating of both assets and profits. This point will be taken up later in the discussion of CAPITAL AND REVENUE EXPENDITURES. A wrong interpretation of the classification of accounts would also lead to errors of principle, though not always affecting the balance sheet.

2. CLERICAL ERRORS. Errors of posting, footing, and balancing are classified here.

3. ERRORS OF OMISSION. These consist of failures to make entries such as sales to customers on account, etc.

4. ERRORS OF COMMISSION. Errors in recording entries, as mistakes in amount, pricing, quantities, extensions (on invoices), are included under errors of commission.

5. OFFSETTING ERRORS. These errors are not common. The term refers to errors of posting, footing, or balancing which are exactly counterbalanced by other such errors and thus would not be disclosed by a trial balance.

REFERENCES:

Belding, pages 41-57
Greendlinger and Schulze, Chapter IX
MacFarland and Rossheim, pages 22-36.
Sprague, Chapters XIV, XV, XIX, XX

COMPLETE ACCOUNTING COURSE--PART I

Lecture 5

PREPARATION OF FINANCIAL STATEMENTS

Problem 2

From the following trial balance abstracted from the books of the retail business of H. A. Walters, October 31, 1917, prepare:

(a) Balance sheet as of October 31, 1917.
(b) Statement of profit and loss for the year ending October 31, 1917, using the report form of statement.
(c) Journal entries necessary to close the books as of October 31, 1917.

ACCOUNT	DEBIT	CREDIT
Land	$ 3,000.00	
Building	10,000.00	
Store Fixtures	4,000.00	
Delivery Equipment	500.00	
Bond Investments	11,000.00	
Inventory of Merchandise, November 1, 1916	9,462.00	
Notes Receivable	1,800.00	
Accounts Receivable	18,640.00	
Cash	3,240.00	
Accounts Payable		$12,846.00
Mortgage Payable		5,000.00
H. A. Walters--Capital Account		40,000.00
H. A. Walters--Drawing Account	1,302.00	
Merchandise	46,982.00	69,420.00
Income on Bond Investments		420.00
Rent Received		760.00
Interest Received		910.00
Sales Clerks' Salaries	5,800.00	
Selling Expenses	3,200.00	
Advertising Expenses	1,600.00	
Delivery Expenses	1,300.00	
Office Expenses	2,900.00	
General Expenses	3,650.00	
Interest Paid	300.00	
Merchandise Discounts	680.00	
	$129,356.00	$129,356.00

The merchandise inventory October 31, 1917, is $15,480; delivery expense supplies inventory is $160; and general expense supplies inventory is $240.

An analysis of the merchandise account shows purchases $42,800, return purchases $4,913, freight on purchases $1,200, allowances on purchases $487, sales $64,020, and return sales $2,982.

WORK TO BE DONE IN THE PRACTICE SET

In the Journal make the entries necessary to close the books of Fred Miller on February 28. The inventory of merchandise on that date is $10,890.

Prepare to be handed in:

(a) Statement of profit and loss for the month ending February 28, 19--, using the account form.
(b) Balance sheet February 28, 19--

The following is the trial balance of the ledger of Fred Miller February 28, before closing.

FRED MILLER
TRIAL BALANCE, FEBRUARY 28, 19--

ACCOUNT	DEBIT	CREDIT
Fred Miller--Capital Account		$11,289.30
Fred Miller--Drawing Account	$ 425.00	
Warehouse and Office Fixtures	1,250.00	
Auto Delivery Truck	1,750.00	
Merchandise Inventory	2,197.50	
E. T. Adams	212.50	
Barnhart & Co.	200.00	
Geo. Wilson	230.00	
Cash	1,183.52	
Wilson Manufacturing Co.		1,600.00
Chicago Furniture Co.		500.00
New York Auto Supply Co.		1,350.00
Merchandise	6,818.10	
Salaries	440.50	
Rent	50.00	
Stationery and Supplies	53.75	
General Expense	78.80	
Interest		.49
Discount on Sales	39.89	
Discount on Purchases		189.77
	$14,929.56	$14,929.56

ANSWERS TO QUESTIONS

Answer to Question 5--

CAPITAL ASSETS are those assets WITH which a business operates; i.e., assets which are more or less permanent, and are acquired to be used for business purposes rather than for resale. Examples are land, buildings, equipment, tools, fixtures, etc. (TANGIBLE capital assets), and patent rights, good-will, etc. (INTANGIBLE capital assets).

CURRENT ASSETS are those assets IN which a business operates; i.e., assets which are held more or less temporarily and which consist of cash, credits extended in lieu of cash (accounts and notes receivable), and merchandise inventories which will soon be turned into cash or credit. The term "current assets" also generally includes items sometimes classified as "working assets," that is, raw materials, work in the process of manufacture, supplies of stationery, coal, etc.

CAPITAL LIABILITIES are not liabilities in the ordinary sense of the word, but represent the investment of the proprietor. Or, stated in another way, capital liabilities are the liabilities of the business to the proprietor. The term may also include long-term liabilities, such as bonds.

CURRENT LIABILITIES are liabilities which are currently due; that is, those becoming due within a year or less.

<u>Answer</u> <u>to</u> <u>Question</u> <u>6</u>--

```
Warehouse and Office Fixtures)
Auto Delivery Truck          )
Merchandise Inventory        ) Asset       )
Accounts Receivable          )             )
Notes Receivable             )             )
Cash                         )             ) Real     )
                                           )          )
Fred Miller--Capital Account )             )          ) Accounts Receivable and
Fred Miller--Drawing Account ) Liability   )          ) Accounts Payable and the
Accounts Payable             )             )          ) Proprietor's accounts
                                                      ) are personal accounts;
Merchandise                  ) Income and  )          ) the remainder are im-
                               Expense     )          ) personal accounts
Salaries                     )             ) Nominal  )
Rent                         )             )
Stationery and Supplies      ) Expense     )
Expense                      )
Interest                     )
Discount                     )
```

<u>Answer</u> <u>to</u> <u>Question</u> <u>7</u>--

C D CO.--CURRENT ACCOUNT

DATE	PARTICULARS	AMOUNT	DATE	PARTICULARS	AMOUNT
1917			1917		
Sept. 5	Returned Purchases	$ 306.00	Sept. 1	Balance	$1,856.00
16	Sale	1,670.00	3	Purchases	3,450.00
25	Check	2,000.00	20	Allowance on Sale	320.00
30	Balance carried down	1,650.00			
		$5,626.00			$5,626.00
			Oct. 1	Balance brought down	$1,650.00

Since the balance of the account is a credit, it should appear among the liabilities.

CLOSING THE BOOKS

By "closing the books" is meant the operation at the end of a FISCAL (or Accounting) period--month or year--required to close out the nominal accounts into the Profit and Loss account, and the Profit and Loss account into the proprietor's account. There are two main purposes of such an operation:

1. To ascertain the net profit or loss for the year and to credit or debit same to the proprietor's account.

2. To secure for each period an analysis of the details and results of operation which will be valuable for subsequent comparison.

After all postings have been completed at the end of a period, a trial balance is taken and journal entries are made to close the nominal accounts. Consider the following trial balance:

TRIAL BALANCE OF JOHN DOE, DECEMBER 31, 1917

John Doe--Capital Account		$ 31,400.00
John Doe--Drawing Account	$ 2,200.00	
Land	4,000.00	
Buildings	12,000.00	
Office Fixtures	3,000.00	
Delivery Equipment	1,000.00	
Investments	10,000.00	
Cash	2,000.00	
Customers' Accounts	18,000.00	
Notes Receivable	3,000.00	
Inventory of Merchandise, January 1, 1917	10,000.00	
Creditors' Accounts		20,000.00
Notes Payable		5,000.00
Bank Loans		6,000.00
Merchandise	44,000.00	61,000.00
Selling Expense	2,000.00	
Advertising	400.00	
Salaries	6,000.00	
General Expense	5,000.00	
Delivery Expense	300.00	
Stationery and Supplies	1,600.00	
Insurance	100.00	
Rent Paid	600.00	
Interest Paid	200.00	
Income on Investments		1,000.00
Interest Received		600.00
Merchandise Discounts		400.00
	$125,400.00	$125,400.00

The following is an analysis of the Merchandise account:

DEBITS		CREDITS	
Purchases	$40,000.00	Sales	$60,000.00
Sales Rebates & Allowances	1,000.00	Purchase Rebates & Allowances	400.00
Return Sales	1,200.00	Return Purchases	600.00
Freight-Out	800.00		
Freight-In	1,000.00		
Total	$44,000.00	Total	$61,000.00

The inventories on hand December 31, 1917, are merchandise $15,000, and stationery and supplies $1,000.

Closing entries may be made in the journal as follows:

(1)

Merchandise	$10,000.00	
To--Inventory of Merchandise, December 31, 1916		$10,000.00
To transfer opening inventory into Merchandise account		

(2)

Inventory of Merchandise, December 31,1917	15,000.00	
To--Merchandise		15,000.00
To record closing inventory as per recapitulation of inventory sheets.		

The purpose of the two entries above may be seen from the study of the following equation: (Review also the discussion of the Merchandise account in I-3-4)

(Inventory at beginning of period) Plus (Purchases during period) = (Cost of Merchandise sold) Plus (Inventory at end of period)

or transposing the last item, the opening inventory ($10,000) PLUS the purchases during the year ($40,000 + $1,000 – $400 – $600, or $40,000) LESS the closing inventory ($15,000) = the cost of the merchandise disposed of by sales ($35,000). By the medium, therefore, of entries (1) and (2) we now have items in the Merchandise account which show the cost of merchandise sold. The remaining items in the Merchandise account show the net sales ($60,000 – $1,000 – $1,200 – $800, or $57,000). The difference between the net sales and the cost of sales is gross profit and is transferred to the Profit and Loss account.

(3)

Merchandise	$22,000.00	
To--Profit and Loss		$22,000.00
To transfer gross profit from trading.		

In case the details of the Merchandise account are carried in separate accounts, as outlined in I-3-5, journal entries would be necessary to transfer (a) opening inventory into Trading account, (b) net purchases to Trading account, (c) closing inventory from Trading to Inventory account, (d) net sales to Trading account, and (e) gross profit from Trading to Profit and Loss account.

If the inventory is carried in the Merchandise account, as in the description of the account appearing in I-3-4, entry (1) as above would not be made. In place of entries (1) and (2) would appear the following:

Merchandise	$15,000.00	
To—Merchandise		$15,000.00
To record closing inventory December 31, 1917.		

The credit of $15,000 would then be posted, but before posting the debit of $15,000, a second entry would be made precisely similar to entry (3) and posted, after which the Merchandise account would balance. The latter account is then ruled off and the debit of $15,000 posted. This is an asset and would therefore remain as an opening item in the Merchandise account for the next fiscal period.

(4)

Inventory of Stationery and Supplies	$1,000.00	
To--Stationery and Supplies		$1,000.00
To set up inventory of supplies not consumed.		

The Stationery and Supplies account is a mixed account and the purpose of the above entry is to separate the inventory, which will remain on the books as an asset, from the nominal part of the account which will be disposed of by closing out to Profit and Loss.

(5)

Income on Investments	$1,000.00	
Interest Received	600.00	
Merchandise Discounts	400.00	
To--Profit and Loss		$2,000.00
To transfer income accounts to Profit and Loss.		

(6)

Profit and Loss	15,200.00	
To--Selling Expense		2,000.00
Advertising		400.00
Salaries		6,000.00
General Expense		5,000.00
Delivery Expense		300.00
Stationery and Supplies		600.00
Insurance		100.00
Rent paid		600.00
Interest paid		200.00
To close out expenses for year.		

It is customary, when posting to the Profit and Loss account, to show full details of the entry. Thus, in entry (6), instead of posting a single debit of $15,200, the detailed expenses making up the total are shown instead.

(7)

Profit and Loss	$8,800.00	
To--John Doe--Drawing Account		$8,800.00
To carry net profit for year to drawing account.		

(8)

John Doe--Drawing Account	6,600.00	
To--John Doe--Capital Account		6,600.00
To transfer balance of drawing account to capital account.		

After the last two entries have been made there will be left on the books only real (asset and liability) accounts.

PREPARATION OF FINANCIAL STATEMENTS

From the foregoing discussion it is evident that two statements may be prepared from the information disclosed by the books; and it is the purpose of FINANCIAL STATEMENTS to present this information in a simple but comprehensive manner. The first of these statements to be prepared will be the STATEMENT OF PROFIT and LOSS or STATEMENT OF PROFITS AND INCOME and will consist of an arrangement of the nominal accounts designed to set out clearly the results from operations for the period under review; the second will be the BALANCE SHEET (called STATEMENT OF ASSETS AND LIABILITIES in single entry) and will consist of a grouping of the real accounts remaining in the ledger after the nominal accounts have been closed out, according to some conventional scheme, for the purpose of setting forth the financial condition at a particular moment of time.

STATEMENT OF PROFIT AND LOSS OR OF PROFITS AND INCOME

The preferable term to employ as a title to this statement is STATEMENT OF PROFITS AND INCOME, inasmuch as the significant points in the statement are (1) the sources of income, (2) the income expended during the course of operations, and (3) the income remaining at the close of the period in the shape of distributable profit. The first-named term is more commonly used, but it labors under the disadvantage of being a misnomer. In a business which has made profits, the inclusion of the word "loss" is contradictory, the only defense being that "loss" is used to refer to "expenses."

ACCOUNT FORM--An analysis of profits that sometimes suffices is the ACCOUNT FORM of statement. This is merely a summary presentation of the nominal ledger accounts and would appear as follows:

JOHN DOE, PROPRIETOR
STATEMENT OF TRADING, PROFIT AND LOSS
YEAR ENDING DECEMBER 31, 1917

TRADING ACCOUNT

Merchandise on Hand, January 1, 1917	$10,000.00	Gross Sales	$60,000.00
Purchases for year	40,000.00	Allowances on Purchases	400.00
Freight-In	1,000.00	Return Purchases	600.00
Allowances on Sales	1,000.00	Merchandise on Hand, December 31, 1917	15,000.00
Return Sales	1,200.00		
Freight-Out	800.00		
Balance--Gross Profit from Trading carried down	22,000.00		
	$76,000.00		$76,000.00

PROFIT AND LOSS ACCOUNT

Selling Expense	$2,000.00	Gross Profit from Trading brought down	$22,000.00
Advertising	400.00		
Salaries	6,000.00		
General Expense	5,000.00		
Delivery Expense	300.00		
Stationery and Supplies	600.00		
Insurance	100.00		
Rent	600.00		
Balance--Net Profit from operation carried down	7,000.00		
	$22,000.00		$22,000.00

Interest Paid	$200.00	Net Profit from operation brought down	$7,000,00
Balance--Surplus Net Profit carried to Drawing Account	8,800.00	Income from Investments	1,000.00
		Interest Received	600.00
		Merchandise Discounts	400.00
	$9,000.00		$9,000.00

The last division of the Profit and Loss account is made for the purpose of displaying "net profit from operation" as distinguished from "surplus net profit." Miscellaneous receipts such as interest, and expenses such as interest paid, are sometimes classified as "non-operating income and expenses," but the line of demarcation between this class of income and expense and that found in the first section of the Profit and Loss account is not always clear.

REPORT FORM--A much clearer method of stating profits is by use of the report form.

JOHN DOE
STATEMENT OF PROFITS AND INCOME
YEAR ENDING DECEMBER 31, 1917

GROSS SALES			$60,000.00
DEDUCT--Rebates and Allowances		$1,000.00	
Return Sales		1,200.00	
Freight-Out		800.00	3,000.00
NET SALES			$57,000.00
DEDUCT--COST OF GOODS SOLD:			
Inventory, January 1, 1917		$10,000.00	
Add--Purchases	$40,000.00		
Freight-In	1,000.00		
	$41,000.00		
Deduct--Returns and Allowances	1,000.00	40,000.00	
Cost of Merchandise Handled		$50,000.00	
Deduct--Inventory, December 31, 1917		15,000.00	35,000.00
GROSS PROFIT FROM SALES			$22,000.00
DEDUCT--ADMINISTRATIVE AND SELLING EXPENSE:			
Salaries		$6,000.00	
General Expense		5,000.00	
Stationery and Supplies		600.00	
Insurance		100.00	
Rent		600.00	
Selling Expense		2,000.00	
Advertising		400.00	
Delivery Expense		300.00	15,000.00
NET PROFIT FROM OPERATION			$7,000.00
ADD--MISCELLANEOUS INCOME:			
Income from Investments		$1,000.00	
Interest Received		600.00	
Merchandise Discounts		400.00	2,000.00
			$9,000.00
DEDUCT--Interest Paid			200.00
SURPLUS NET PROFITS carried to Proprietor's Account			$8,800.00

BALANCE SHEET

There are two ways in which balance sheets are prepared: (1) with capital assets preceding current assets and capital liabilities preceding current liabilities; or (2) with current assets preceding capital assets and current liabilities preceding capital liabilities. In either case, in American practice, the assets are on the left and liabilities on the right, and both assets and liabilities are grouped.

1. In the following illustration capital assets precede the current, or the more liquid follow the less liquid:

JOHN DOE
BALANCE SHEET, DECEMBER 31, 1917

ASSETS			CAPITAL AND LIABILITIES		
CAPITAL ASSETS:			CAPITAL ACCOUNT:		
Land	$4,000.00		Balance, January 1, 1917		$31,400.00
Buildings	12,000.00		Add--Profit for year		8,800.00
Office Fixtures	3,000.00				$40,200.00
Delivery Equipment	1,000.00				
Investments	10,000.00	$30,000.00	Deduct--Drawings		2,200.00
CURRENT ASSETS:			Balance, December 31, 1917		$38,000.00
Inventory of Mdse.	$15,000.00		CURRENT LIABILITIES:		
Inventory of Supplies	1,000.00		Accounts Payable	$20,000.00	
Customers' Accounts	18,000.00		Notes Payable	5,000.00	
Notes Receivable	3,000.00		Bank Loans	6,000.00	31,000.00
Cash	2,000.00	39,000.00			
		$69,000.00			$69,000.00

2. In the following illustration current assets precede the capital, or the less liquid follow the more liquid:

JOHN DOE
BALANCE SHEET, DECEMBER 31, 1917

ASSETS			LIABILITIES AND CAPITAL		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash	$2,000.00		Accounts Payable	$20,000.00	
Notes Receivable	3,000.00		Notes Payable	5,000.00	
Customers' Accounts	18,000.00		Bank Loans	6,000.00	$31,000.00
Inventory of Mdse.	15,000.00		CAPITAL ACCOUNT:		
Inventory of Supplies	1,000.00	$39,000.00	Balance, January 1, 1917	$31,400.00	
CAPITAL ASSETS:			Add--Profit for year	8,800.00	
Land	$4,000.00			$40,200.00	
Buildings	12,000.00		Deduct--Drawings	2,200.00	
Office Fixtures	3,000.00		Balance, December 31, 1917		$38,000.00
Delivery Equipment	1,000.00				
Investments	10,000.00	30,000.00			
		$69,000.00			$69,000.00

If the inclusion of all individual ledger accounts should make either statement too complex, assets of like character should be totaled and the total only shown on the statement. This total should then be supported by a separate schedule listing the detail items. A similar treatment may be adopted for liabilities, capital accounts, expenses, etc.

REFERENCES:

Gilman, Chapter IV
Greendlinger & Schulze, Chapters XIII, XIV
Lisle, pages 55-63

COMPLETE ACCOUNTING COURSE--PART I

Lecture 6

PARTNERSHIPS

Problem 3

The following trial balance has been abstracted from the books of H. A. Cole who has now entered into a partnership agreement with W. H. Nelson:

PARTICULARS	DEBITS	CREDITS
Land	$12,000.00	
Buildings	13,000.00	
Machinery and Tools	12,000.00	
Notes Receivable	2,700.00	
Customers' Accounts	15,500.00	
Accounts Payable		$12,200.00
Notes Payable		6,000.00
Cash	2,100.00	
Merchandise (Inventory)	37,500.00	
H. A. Cole--Capital Account		76,600.00
	$94,800.00	$94,800.00

It was agreed in the articles of copartnership that H. A. Cole was to contribute the assets and liabilities represented in the above trial balance, and that W. H. Nelson was to contribute cash $25,000, land $4,000, buildings $20,000, and notes receivable $6,000.

Prepare the entries necessary to:

(a) Record on the books of H. A. Cole the transfer of the assets and liabilities to the new firm of Cole and Nelson.

(b) Open the books of the new firm with respect to the contribution of each partner.

Problem 4

Fred Mack and John Schmidt are engaged as partners in a general merchandise business known as Mack & Schmidt. A clause of the partnership agreement respecting the division of profits and losses reads as follows:

"The books shall be closed annually, at December 31 of each year, for the ascertainment of profits and the adjustment of the interests of the partners. During the existence of this partnership Fred Mack shall be allowed a salary of $6,000 per annum, and John Schmidt a salary of $4,000 per annum, payable monthly.

"Interest at 6% per annum shall be allowed on the balances of their capital account at the beginning of each fiscal year.

"Drawings shall not exceed the salary allowances of the partners, as aforesaid, except by mutual consent.

"The remaining profit or loss, as the case may be, shall be divided equally between the partners."

Mack's capital account on January 1, 1917, was $70,000 and Schmidt's $50,000. No adjustments were made for partners' salaries, but Mack's drawing account showed withdrawals during the year of $4,000, and Schmidt's of $5,000. The excess drawing of Schmidt had been made with the knowledge and consent of Mack.

Upon closing the books on December 31, 1917, the net profit, before allowing for partners' salaries or interest on their capital, was ascertained to be $11,000.

You are required to prepare:

(a) Statement showing division of net profit for year ending December 31, 1917.

(b) Statement of partners' capital accounts as of December 31, 1917.

MISCELLANEOUS QUESTIONS

Question 13--Doe and Roe enter into a partnership, Doe investing real estate valued in the partnership agreement at $10,000, and Roe investing $8,000 in cash. The partnership agreement stated that profits and losses were to be divided equally. During the year the real estate was sold for $12,000. The business was unsuccessful, and at the end of the year it was found, after liquidation, that there was a loss of $3,000 before considering the real estate transaction.

The partners wish to know how much each one is entitled to.

Question 14--The balance sheet of James and Smith appears on December 31, 19--, as follows:

BALANCE SHEET OF JAMES AND SMITH

Miscellaneous Assets	$30,000.00	James--Capital Account	$10,000.00
		Smith--Capital Account	20,000.00
	$30,000.00		$30,000.00

They divide profits and losses, Smith 2/3 and James 1/3.

Smith sells a half of his interest to Cole for $15,000 and a new partnership is formed, each partner to have a one-third interest in the assets.

Formulate the entry necessary to give effect to the above change on the books of James and Smith.

Question 15--Continuing the illustration in Question 14, assume the agreement had been that Cole is to receive a third interest in the capital of the business by investing $7,000 in cash, and formulate the journal entries required to adjust the capital accounts of the partners.

Question 16--Distinguish between trade and cash discount. What is the meaning of 7/10, n/60? Is this cash discount or trade discount?

Question 17--An invoice amounting to $1,000 reads: "less 30%, 10% and 5%; terms 2/10, n/30." It is dated August 16 and is paid on the 18th. What should be the amount of the check?

WORK TO BE DONE IN THE PRACTICE SET

The business of Fred Miller has now developed to a point where he feels he requires assistance in its administration. An arrangement is made with his brother, August Miller, to invest $15,000 and become sales manager. Fred Miller is to contribute additional cash to bring his capital up to that of August Miller. The partnership agreement, inter alia, provides that:

1. Name of the new firm shall be--MILLER BROTHERS.
2. Scope of business--purchase and sale of automobiles and accessories and supplies.
3. Place of business--Chicago, Ill.
4. Assets and liabilities of Fred Miller to be taken over by the new firm at the book balances of February 28, 19--.
5. No interest to be allowed on capital accounts.
6. Profits and losses to be divided as follows:
   Fred Miller 66 2/3%
   August Miller 33 1/3%
7. Partnership agreement to become effective on and after March 1, 19--.

You are required to:

(a) Prepare but not post entries to close the books of Fred Miller as of February 28, 19--.

(b) Prepare but not post the entries to open the books of MILLER BROTHERS, the new partnership.

Solution to Assignment I-5-2

FINANCIAL STATEMENTS OF FRED MILLER, FEBRUARY 28, 19--

FRED MILLER — Exhibit A

BALANCE SHEET, FEBRUARY 28, 19--

ASSETS			LIABILITIES	
CAPITAL ASSETS:			CAPITAL ACCOUNT:	
Warehouse and Office Fix.	$ 1,250.00		Balance, February 1	$11,289.30
Auto Del. Truck	1,750.00	$ 3,000.00	Add--Profits for February (Exhibit B)	1,401.72
CURRENT ASSETS:				$12,691.02
Merchandise Inventory	$10,890.00		Deduct--Drawings	425.00
Customers' Accounts	642.50		Balance, February 28	$12,266.02
			CURRENT LIABILITIES:	
Cash	1,183.52	12,716.02	Accounts Payable	3,450.00
Total		$15,716.02	Total	$15,716.02

FRED MILLER
STATEMENT OF PROFIT AND LOSS
MONTH ENDING FEBRUARY 28, 19--

TRADING ACCOUNT

Inventory, February 1, 19--		$ 2,197.50	Gross Sales	$5,200.75	
Purchases	$11,963.60		Deduct--Allowances and		
Deduct--Returns	75.00	11,888.60	Returns	132.50	$5,068.25
Balance--Gross Profit from Sales carried down		1,872.15	Inventory, February 28, 19--		10,890.00
		$15,958.25			$15,958.25

PROFIT AND LOSS ACCOUNT

Salaries	$ 440.50	Gross Profit from Sales brought down	$1,872.15
Rent	50.00		
General Expense	76.55		
Stationery and Supplies	53.75		
Balance--Net Profit from Operations carried down	1,251.35		
	$1,872.15		$1,872.15
Discount on Sales	$ 39.89	Net Profit from Operations brought down	$1,251.35
Balance--Surplus Net Profit carried to Drawing Account	1,401.72	Discounts on Purchases	189.77
		Interest Received	.49
	$1,441.61		$1,441.61

JOURNAL ENTRIES NECESSARY TO CLOSE THE BOOKS
OF FRED MILLER, FEBRUARY 28, 19--

(1)

Merchandise	$2,197.50	
To--Inventory of Merchandise		$2,197.50
To transfer inventory February 1, 19--.		

(2)

Inventory of Merchandise	10,890.00	
To--Merchandise		10,890.00
To set up inventory February 28, 19--.		

(3)

Merchandise	$1,872.15	
Discounts on Purchases	189.77	
Interest	.49	
To--Profit and Loss		$2,062.41
To close out income accounts.		

(4)

Profit and Loss	660.69	
To--Salaries		440.50
Rent		50.00
General Expense		76.55
Stationery and Supplies		53.75
Discount on Sales		39.89
To close out expense accounts.		

(5)

Profit and Loss	1,401.72	
To--Fred Miller--Drawing account		1,401.72
To close surplus net profit into Drawing account.		

(6)

Fred Miller--Drawing Account	976.72	
To--Fred Miller--Capital Account		976.72
To transfer balance of Drawing account.		

ANSWERS TO QUESTIONS

Answer to Question 8--A system of internal check is a method of doing business whereby routine work is performed at least cost and in such manner that collusion between two or more persons must be involved before error or fraud can remain undetected in the accounts and records. The character of the system will of course depend on the nature of the business, its size, and personnel. It involves the methods in use for handling cash, petty cash, sales, return sales, purchases, return purchases, stock, wages, ledgers, etc.

The elements of a good system of internal check will be found in Montgomery's Auditing, Second Edition, pages 53-58.

Answer to Question 9--Entries on A B Co's books:

-September 3, 1916-

Purchases (or Merchandise account)	$3,450.00	
To--C D Co.		$3,450.00
To record purchases as per their invoice dated September 2, 1916, terms 2/10, n/30.		

-5-

C D Co.	306.00	
To--Purchases (or Return Purchases)		306.00
To record merchandise returned as per our letter dated today, and their credit memorandum received September 8, #43560.		

-16-

C D Co.	$1,670.00	
To--Sales		$1,670.00
To record sales as per our invoice #A6715 dated today.		

-20-

Allowances on Sales (or Sales)	320.00	
To--C D Co.		320.00
To record allowance as per our credit memorandum #3742 made today.		

-25-

C D Co.	2,000.00	
To--Cash		2,000.00
Check #57641. (This entry would be made in the cash book.)		

Answer to Question 10--The fact that the total debits equal the total credits does not prove conclusively that the ledger is in balance. There may be an offsetting error in the postings, in abstracting ledger balances, in footing the ledger, in taking off the trial balance, or even in footing the trial balance. Such instances are not frequent, however.

It would not be safe to write off a small difference. The small difference may be caused by two or more large discrepancies, one a debit and the other a credit.

Answer to Question 11--In closing a cash book the balance on hand and in bank at the end of the month should be shown on the disbursement side of the current month. On the first of next month the balance should be brought down on the cash receipts side.

The total cash receipts and disbursements are posted monthly to the debit and credit respectively of the cash account in the ledger. Hence, the balance at the end of the month in that account should agree with the amount called for by the cash book. It will be seen that the cash account in the ledger is supported by the detailed record of cash receipts and disbursements in the cash book.

The cash account in the general ledger serves as a controlling account for cash. Its presence is especially desirable where there is more than one cash book in order that the summaries of receipts and disbursements may be plainly shown.

Answer to Question 12--The function of a ledger is to collect in the form of accounts the detailed operations appearing in the various books of original entry. The accounts may be elaborated to any extent desired in order that the required information may be properly presented.

PARTNERSHIPS

DEFINITION--A PARTNERSHIP or FIRM is the relationship existing between two or more persons who combine their property, credit, and services for the purpose of conducting a business for mutual profit.

KINDS OF PARTNERSHIPS--The ordinary partnership is the GENERAL UNLIMITED PARTNERSHIP, that is, one engaged in some general line of business and unlimited as to the liability of its members to creditors.

A SPECIAL PARTNERSHIP is a partnership in some particular enterprise, usually limited to certain specified transactions. An example is the JOINT ADVENTURE (see I-10-1).

A LIMITED PARTNERSHIP is a partnership in which one or more members have a limited liability to creditors, usually confined to the amount of their subscription or investment. Such partners are called SPECIAL PARTNERS. There must be at least one member who is a GENERAL PARTNER--one whose liability to creditors is not limited.

Partnerships are also classified as TRADING and NON-TRADING PARTNERSHIPS, the latter consisting of professional firms (lawyers, accountants, etc.) and other firms who render services rather than buy and sell merchandise.

ARTICLES OF PARTNERSHIP--No written agreement need be made to establish a partnership. However, it is usual to draw up "articles of partnership" upon its formation, and to state, inter alia:

1. Names of partners.
2. Name of partnership.
3. Scope of business; place of business.
4. Date partnership commences; duration.
5. Contributions of each partner, whether property or merely use of property.
6. Interest allowed on investment; how computed.
7. Basis of sharing profits and losses.
8. Duties of partners and salaries allowed.
9. Drawings of partners and interest charged thereon.
10. Books of account; audit.
11. Dissolution of partnership; shares in good-will, etc.

METHODS OF DISTRIBUTING PROFITS--

1. Equally, in the absence of any provision in the articles of partnership.
2. On amount of capital:
   (a) At beginning of fiscal period.
   (b) At end of fiscal period.
   (c) Average investment during period.
3. Arbitrary percentages.
4. In event of liquidation the same basis of profit-sharing prevails as in a going concern, unless provision to the contrary is found in the articles of partnership.

CAPITAL ACCOUNTS WITH PARTNERS--In a partnership an account should be kept for the capital investment of each partner, known as his capital account. As a rule each partner LOSES INDIVIDUAL OWNERSHIP of any asset which he invests in the business conducted by the partnership and receives an undivided interest in all the assets of the business; and any profits derived from it are likewise the profits of the business rather than of the individual.

The interest of a partner in the capital of the partnership is his original investment and the increases or decreases therein arising from his proportion of subsequent profits or losses. To his interest is added, of course, additional funds invested, while withdrawals are deducted.

Distinction should be made here between interest in the capital of the partnership and interest in the profits and losses. The proportion need not be the same in both cases.

DRAWING ACCOUNTS WITH PARTNERS--The amount a partner may withdraw depends on the articles of partnership. If there is no provision in regard to this he can withdraw his profits only by the consent of the remaining partners. A separate account is usually kept. As in a single proprietorship, the net profit for a period is carried to the drawing accounts, and the balance of the drawing accounts transferred to the capital accounts. Interest allowed on capital investment is also credited to drawing accounts.

CLOSING PROFIT AND LOSS ACCOUNT INTO DRAWING ACCOUNTS

Having closed all the nominal accounts into the Profit and Loss account at the end of a fiscal period, the final step remains to show the distribution of the profits as between partners. The surplus net profit may be brought down and distributed in the following manner:

PROFIT AND LOSS ACCOUNT

Salaries		$4,000.00	Gross Profit from Trading	
Stationery and Supplies		360.00	Account	$8,660.00
Rent		300.00		
Light and Heat		670.00		
General Expense		470.00		
Net Profit carried down		2,860.00		
		$8,660.00		$8,660.00
Interest on Capital Accounts:			Net profit brought down	$2,860.00
Accounts:				
Brown	$750.00			
White	870.00	$1,620.00		
Division of remainder of profits				
Brown--½	$620.00			
White--½	620.00	1,240.00		
		$2,860.00		$2,860.00

The journal entries required to close the second section of the preceding account would appear as follows:

(1)

Profit and Loss	$1,620.00	
To--Brown--Drawing Account		$750.00
White--Drawing Account		870.00

To credit partners' accounts with interest as follows:
Brown--6% on balance of Capital account at beginning of year ($12,500.00) $750.00
White--6% on balance of Capital account at beginning of year ($14,500.00) $870.00

(2)

Profit and Loss	1,240.00	
To--Brown--Drawing Account		620.00
White--Drawing Account		620.00

To credit partners' accounts with remainder of profits, one-half to each.

Brown's drawing account would appear as follows, after giving effect to the above entries:

BROWN--DRAWING ACCOUNT

Drawing during year (already in account)	$1,000.00	Interest on Capital invested	$750.00
Balance--Transferred to Capital Account	370.00	One-half balance of Profits	620.00
	$1,370.00		$1,370.00

REFERENCES:

Bays, The Law of Partnership (American Commercial Law series, Vol. IV)
Esquerre, Chapter I
Gilman Chapter IX
Greendlinger and Schulze, Chapters XV and XVI
Hatfield, Chapter XVII

COMPLETE ACCOUNTING COURSE--PART I

Lecture 7

EXPANSION OF BOOKKEEPING RECORDS

Problem 5

Stone and Madison form a partnership with a main office in Chicago and a branch in Evanston. On July 31, 1917, the following trial balance was abstracted from the books of the Chicago office:

ACCOUNT	DEBIT	CREDIT
Land and Buildings	$12,000.00	
Office Fixtures	1,500.00	
Merchandise Inventory, July 31, 1917	12,500.00	
Accounts Receivable	10,100.00	
Evanston Office	4,500.00	
Cash	8,900.00	
A. Stone--Capital Account		$20,000.00
B. Madison--Capital Account		15,000.00
Accounts Payable		8,500.00
Profit and Loss		6,000.00
	$49,500.00	$49,500.00

A trial balance was also prepared from the books of the Evanston branch:

Office Fixtures	$500.00	
Merchandise Inventory, July 31, 1917	4,500.00	
Accounts Receivable	6,000.00	
Cash	1,500.00	
Chicago Office		$4,000.00
Accounts Payable		5,000.00
Profit and Loss		3,500.00
	$12,500.00	$12,500.00

The discrepancy of $500 between the Evanston office account and the Chicago office account is explained by the fact that merchandise amounting to this sum was shipped by the Chicago office to the Evanston branch, being received by the latter on July 31, 1917, but not yet recorded by them either in the inventory or in the Chicago office account.

Prepare journal entries necessary to close the books of both main office and branch for the year, assuming each partner to be entitled to one-half the net profits. Draw up a balance sheet showing the financial position of main office and branch together.

MISCELLANEOUS QUESTIONS

Question 18--

(a) Illustrate a method of ruling the cash book of Miller Bros. at the end of each month which will indicate clearly the accounts to which totals of columns are to be posted and the correctness of the cross footings.

(b) Do you consider it desirable or necessary to make a journal entry in the general journal summarizing the cash book totals?

Question 19--Explain how equal debits and credits are maintained in the cash disbursements book which Miller Bros. will keep, and show also the nature of postings which will be made therefrom.

WORK TO BE DONE IN THE PRACTICE SET

The following schedule of accounts will be used by the new firm of Miller Bros. The accounts should be opened in the order indicated. New forms to be used are: (1) journal (Form 3); (2) cash (Form 10).

MILLER BROS.
SCHEDULE OF ACCOUNTS

GENERAL LEDGER

101 Warehouse and Office Equipment
121 Delivery Equipment
151 Good-Will
201 Miller Motor Car Co. Common Stock
202 Miller Motor Car Co. Preferred Stock
301 Inventory of Merchandise
302 Inventory of Miscellaneous Suppl.
303 Consignment Stock Outward
304 Advances on Consignments-Inward
321 Customers Ledger
331 Notes Receivable
332 Interest Accrued on Notes Receivable
341 Cash in Bank
342 Petty Cash Fund
401 Unexpired Insurance
402 Rent Paid in Advance
403 Interest Prepaid
501 Creditors Ledger
511 Notes Payable
521 Bank Loan
551 Notes Receivable Discounted
561 Miller Motor Car Co., Vendee
601 Taxes Accrued
602 Interest Accrued on Notes Payable
701 Fred Miller--Capital Account
702 August Miller--Capital Account
711 Fred Miller--Drawing Account
712 August Miller--Drawing Account
751 Profit and Loss
801 Auto Sales
802 Auto Freight-Out
803 Auto Return Sales
804 Auto Rebates and Allowances
811 A & S Sales
812 A & S Freight-Out
813 A & S Return Sales
814 A & S Rebates and Allowances
841 Auto Trading
842 A & S Trading
851 Sales of Consignments-Outward
861 Earnings on Consignments-Inward
862 Profits on Consignments-Outward
881 Discount on Purchases
891 Interest Received
901 Auto Purchases
902 Auto Freight-In
911 A & S Purchases
912 A & S Freight-In
915 A & S Return Purchases
951 Rent
952 Taxes
953 Insurance
954 Office Salaries and Expense
955 General Expense
961 Delivery Expense
962 Advertising
963 Salesmen's Salaries and Commissions
964 Salesmen's Traveling Expenses
965 Miscellaneous Selling Expenses
981 Interest Paid
982 Discounts on Sales

CUSTOMERS LEDGER
E. T. Adams
Barnhart and Co.
Cash Sales
C. O. D. Sales
James Garage Co.
W. F. Newton
Frank Rice
George Wilson

CREDITORS LEDGER
Chicago Furniture Co.
New York Auto Supply Co.
Well-Built Auto Co.
Wilson Manufacturing Co.

Accounts 701-712 should be on two-account pages, account 751 on a one-account page, and the remaining accounts on three-account pages.

SUMMARY OF TRANSACTIONS

MARCH 1

Post the entries necessary to open the books of Miller Bros. Received 20 automobiles from the Well-Built Auto Co., invoice No. 7866, terms 2% cash in five days, $30,000.

MARCH 2

Sale to E.T. Adams of two automobiles for $2,000 each, terms 30 days.

MARCH 3

Paid Chicago Furniture Co.'s bill of $500, being allowed a 2% discount thereon. Paid freight of $500 on purchase of automobiles from Well-Built Auto Co. on March 1.

MARCH 4

Additional storage facilities were rented for the six months ending August 31, 19--, from National Storage Co., for $300 which was paid at once. (Charge Rent Paid in Advance account.) Sale to George Wilson of auto supplies, amounting to $8,000, terms 2% cash in 5 days.

MARCH 5

Received $196 cash from Barnhart & Co. in full of account, they having deducted $4 discount from their bill, which we allow. Paid salesman's salary amounting to $90 for month of March.

MARCH 6

Paid salary of bookkeeper $60 (charge to Office Expenses). Purchased from Wilson Manufacturing Co. auto supplies, $12,580, invoice No. 678, terms 1% 10 days, net 60 days. Paid for hay and grain purchased from Marks Grain Co., $253 (charge Delivery Expenses).

MARCH 7

Sale to Frank Rice of 8 autos, $18,000, terms 1% cash 10 days, net 60 days. Received from E. T. Adams & Co. $212.50 to apply on account.

Solution to Assignment I-6-3

ENTRIES ON THE BOOKS OF FRED MILLER TO RECORD THE TRANSFER OF ASSETS AND LIABILITIES TO THE FIRM OF MILLER BROS.

(1)

Miller Bros., Vendee	$15,716.02	
To--Warehouse and Office Fixtures		$ 1,250.00
Auto Delivery Truck		1,750.00
Cash		1,183.52
Merchandise Inventory		10,890.00
E. T. Adams		212.50
Barnhart & Co.		200.00
Geo. Wilson		230.00
To record the transfer of assets of Fred Miller to Miller Bros.		

(2)

Chicago Furniture Co.	500.00	
New York Auto Supply Co.	1,350.00	
Wilson Manufacturing Co.	1,600.00	
To--Miller Bros., Vendee		3,450.00
To record the transfer of liabilities of Fred Miller to Miller Bros.		

(3)

Fred Miller--Capital Account	12,266.02	
To--Miller Bros., Vendee		12,266.02
To record the transfer of Fred Miller's capital account to Miller Bros.		

ENTRIES ON THE BOOKS OF MILLER BROS. TO RECORD THE RECEIPT OF ASSETS AND ASSUMPTION OF LIABILITIES TURNED OVER TO THE FIRM BY FRED MILLER

(1)

Warehouse and Office Fixtures	$ 1,250.00	
Auto Delivery Truck	1,750.00	
Cash	1,183.52	
Merchandise Inventory	10,890.00	
E. T. Adams	212.50	
Barnhart & Co.	200.00	
Geo. Wilson	230.00	
To--Fred Miller--Capital Account		$15,716.02
To record on the books of Miller Bros., the assets turned over to the firm by Fred Miller.		

(2)

Fred Miller--Capital Account	$ 3,450.00	
To--Chicago Furniture Co.		$ 500.00
New York Auto Supply Co.		1,350.00
Wilson Manufacturing Co.		1,600.00
To record on the books of Miller Bros., the liabilities assumed on behalf of Fred Miller.		

(3)

Cash	2,733.98	
To--Fred Miller--Capital Account		2,733.98
To record cash contributed by Fred Miller to bring his investment up to $15,000 as per agreement.		

(4)

Cash	15,000.00	
To--August Miller--Capital Account		15,000.00
To record cash paid in as per partnership agreement.		

Entries (3) and (4) will appear in the cash book.

Solution to Problem 2 — Exhibit A

H. A. WALTERS
BALANCE SHEET, OCTOBER 31, 1917

ASSETS			LIABILITIES	
CAPITAL ASSETS:			CAPITAL ACCOUNT:	
Land	$ 3,000.00		Balance, November 1, 1916	$40,000.00
Buildings	10,000.00		Profits for year (per Exhibit B)	11,516.00
Store Fixtures	4,000.00			$51,516.00
Delivery Equipment	500.00		Deduct--Drawings	1,302.00
Bond Investment	11,000.00	$28,500.00	Balance, October 31, 1917	$50,214.00
CURRENT ASSETS:			MORTGAGE PAYABLE	5,000.00
Inventory of Mdse.	$15,480.00		CURRENT LIABILITIES:	
Inventory Supplies	400.00		Accounts Payable	12,846.00
Accounts Receivable	18,640.00			
Notes Receivable	1,800.00			
Cash	3,240.00	39,560.00		
		$68,060.00		$68,060.00

H. A. WALTERS
STATEMENT OF PROFITS AND INCOME
YEAR ENDING OCTOBER 31,1917

GROSS SALES		$64,020.00	
Deduct--Return Sales		2,982.00	
NET SALES			$61,038.00
DEDUCT--COST OF SALES:			
Inventory, November 1, 1916		$ 9,462.00	
Purchases	$42,800.00		
Add--Freight thereon	1,200.00		
	$44,000.00		
Deduct--Returns and Allowances	5,400.00	38,600.00	
Cost of Goods Handled		$48,062.00	
Deduct--Inventory, October 31, 1917		15,480.00	32,582.00
GROSS PROFIT ON SALES			$28,456.00
DEDUCT--SELLING AND GENERAL EXPENSE:			
Selling Expense:			
Sales Clerks' Salaries	$5,800.00		
Advertising Expenses	1,600.00		
Delivery Expenses	1,140.00		
Selling Expenses	3,200.00	$11,740.00	
General Expense:			
Office Expense	$2,900.00		
General Expense	3,410.00	6,310.00	18,050.00
NET PROFIT FROM OPERATIONS			$10,406.00
ADD--OTHER INCOME:			
Income from Bond Investments		$420.00	
Rent Received		760.00	
Interest Received		910.00	2,090.00
			$12,496.00
DEDUCT--Interest Paid		$300.00	
Discounts on Sales		680.00	980.00
SURPLUS NET PROFIT (per Exhibit A)			$11,516.00

ENTRIES TO CLOSE BOOKS OF H. A. WALTERS ON OCTOBER 31, 1917

(1)		
Merchandise	$ 9,462.00	
To--Inventory of Merchandise		$9,462.00
To close out opening inventory at Nov. 1, 1916.		
(2)		
Inventory of Merchandise, October 31, 1917	15,480.00	
To--Merchandise		15,480.00
To set up closing inventory at Oct. 31, 1917.		
(3)		
Delivery Expense Supplies Inventory	160.00	
To--Delivery Expenses		160.00
To set up delivery supplies not used at October 31, 1917.		
(4)		
General Expense Supplies Inventory	240.00	
To--General Expenses		240.00
To set up general expense supplies not consumed.		
(5)		
Merchandise	28,456.00	
Income on Bond Investments	420.00	
Rent Received and Accrued	760.00	
Interest Received	910.00	
To--Profit and Loss		30,546.00
To close out income accounts.		
(6)		
Profit and Loss	19,030.00	
To--Sales Clerks' Salaries		5,800.00
Selling Expenses		3,200.00
Advertising Expenses		1,600.00
Delivery Expenses		1,140.00
Office Expenses		2,900.00
General Expenses		3,410.00
Interest Paid		300.00
Merchandise Discounts		680.00
To close out expense accounts.		
(7)		
Profit and Loss	11,516.00	
To--H. A. Walters--Drawing Account		11,516.00
To close net profit into Drawing Account.		
(8)		
H. A. Walters--Drawing Account	10,214.00	
To--H. A. Walters--Capital Account		10,214.00
To close balance of Drawing account into Capital account.		

EXPANSION OF BOOKKEEPING RECORDS

The larger a business the more detailed the information required from the books of account; this necessitates a larger force of bookkeepers and a division of the books so that all may work on them. It then becomes desirable to install some check other than a general trial balance against the postings of the ledger-keepers, and this has given rise to CONTROLLING ACCOUNTS. Another device common in most systems of accounts is the COLUMNAR JOURNAL, whose purpose is to lessen the number of postings from journal to ledger.

CONTROLLING ACCOUNTS

DEFINITION--A CONTROLLING ACCOUNT is a general ledger account to which are posted totals of items that have been posted individually to subsidiary accounts carried in a SUBSIDIARY LEDGER.

KINDS OF CONTROLLING ACCOUNTS--Controlling accounts are usually provided for all the ledgers except the general ledger, such as:

1. Customers Ledger
2. Creditors Ledger
3. Private Ledger
4. Expense Ledgers
5. Plant and Equipment Ledger, etc.

A subsidiary ledger with its controlling account may be provided for any class of transactions so numerous that a substantial share of the time of one or more clerks is required to keep it, or for one or more accounts regarded as confidential.

OPERATION OF CONTROLLING ACCOUNTS--The following skeleton ledger account illustrates the nature of postings to the customers ledger controlling account:

CUSTOMERS LEDGER CONTROLLING ACCOUNT

DEBITS	CREDITS
Total of opening balances	Cash
Sales carried on subsidiary ledger	Discounts
Protested or returned checks,	Returns and allowances
notes, etc.	Notes and acceptances
Other cash debits	Accounts written off
Interest	Other journal credits
Other journal debits	

The balance of this account will be a debit and should equal the total of the balances of the accounts in the customers ledger.

The first debit is the balance of the account brought down from the previous period. The second comes from the total of sales recorded in the sales book, the details making up the total sales having been posted to accounts in the customers ledger. The third and fourth debits come from the cash disbursements book and may be the total of a special column provided for that purpose; or if no special column has been provided, each item falling under this head must be POSTED TWICE from the cash disbursements book: first to the debit of the customer's account, and second to the debit of the customers ledger controlling account. The fifth and sixth debits come from a total of a special column in the general journal.

The first and second credits are posted from the total of a special column in the cash receipts book, while the remaining credits come from the total of a special column in the general journal.

It will be seen from the preceding outline that the totals of special columns in books of original entry compose the various debits and credits appearing in the controlling account. In case no special column appears in a book of original entry, an item posted as a debit or credit to an account in a subsidiary ledger must be posted as a debit or credit, respectively, to the subsidiary ledger's controlling account. The subsidiary ledger is, therefore, in a certain sense but a detailed memorandum record of a ledger account, and ALL items posted to one must be posted, individually or in total, to the other.

Customers ledgers may be divided into several groups with as many controlling accounts; likewise expense ledgers, etc.

A list of balances drawn from a subsidiary ledger is called a "trial balance," but it differs from the one previously described. The latter ascertains whether the total debit balances equal the total credit balances, while the former usually consists entirely of debits or entirely of credits the total of which must equal the debit or credit balance of controlling account.

THE PRIVATE LEDGER--The operation of controlling accounts and subsidiary ledgers for customers, creditors, expenses, plant and equipment, and other asset accounts is much alike. The handling of a private ledger is somewhat different. A PRIVATE LEDGER is a ledger containing information considered confidential and is therefore usually kept by an officer or trusted employee. This information may consist of partners' capital and drawing accounts, officers' salaries, merchandise inventory, capital asset accounts, certain liabilities, etc.

In connection with a private ledger it is usual to find a PRIVATE JOURNAL. The source of entries in the private journal is the transactions affecting the private ledger account. As soon as the private journal is introduced it is customary to find an account in the private ledger called "General Ledger Account" which, if the private ledger account in the general ledger is a credit, will appear as a debit and be equal in amount; and vice versa. Before preparing financial statements the trial balance of both ledgers will be combined, omitting the private ledger account and the general ledger account.

COLUMNAR JOURNALS

DEFINITION--A COLUMNAR JOURNAL is a book of original entry in which columns have been introduced for the purpose of classifying the transactions and thus lessening the number of postings.

KINDS OF COLUMNAR JOURNALS--There are many varieties of columnar journals:

1. Cash Receipts Book
2. Cash Disbursements Book
3. Sales Book
4. Purchase Book
5. Notes Receivable Register
6. Notes Payable Register
7. Insurance Register
8. Account Sales Register
9. Voucher Register
10. General Journal, etc.

OPERATION OF COLUMNAR JOURNALS--All columnar journals must conform to the principle of an equal debit and credit for each entry. With this in mind a few transactions may be traced through, using as models the journals of Miller Bros.:

TRANSACTION	DEBIT	CREDIT
1. Customer pays cash on account. Entered in cash receipts book, amount being placed in column headed "Customers Ledger."	To cash; will be included with other items under "Bank Deposits" as soon as deposit is made; total cash receipts posted as debit to cash account at end of month.	To customer, posted direct; will also be a credit to "Customers Ledger" account when total of column is posted at end of month.
2. Customer settles account by giving note. Entered in journal, amount being placed both in debit "General Ledger" column and credit "Customers Ledger" column.	To notes receivable; posted direct.	Same as above.
3. A note payable is paid. Entered in cash disbursement book, amount being placed both in "General Ledger" column and "Bank Withdrawals" column.	To notes payable; posted direct.	To cash; total cash disbursements posted to credit of cash account at end of month.
4. An auto is sold to a customer. Entered in sales book, amount being placed in "Amount" column and in "Auto Sales" column.	To customer, posted direct; will also be a debit to "Customers Ledger" account when total of "Amount" column is posted at end of month.	To Auto Sales; total of "Auto Sales" column posted to credit of "Auto Sales" account at end of month.

The special columns may be regarded as temporary resting-places for constantly recurring items. At the end of the month, or other convenient period, the columns are footed, the correctness proved by cross-footing, and the totals, except that of the "General Ledger" columns, posted to the proper accounts. There is no need of posting the total of the "General Ledger" column since all the details therein have already been posted to accounts in the general ledger.

REFERENCES:

Cole, Chapter VI
Esquerre, Chapters XI and VIII

COMPLETE ACCOUNTING COURSE--PART I

Lecture 8

CASH

Problem 6

From the following trial balance and other information prepare:

(a) Balance sheet at December 31, 1917.

(b) Statement of profit and loss for year ending December 31, 1917, using report form of statement.

(c) Statement of partners' capital accounts at December 31, 1917.

WAHR AND COOK--TRIAL BALANCE AT DECEMBER 31, 1917

John Wahr--Capital Account		$30,000.00
John Cook-- " "		10,000.00
John Wahr--Drawing Account	$2,000.00	
John Cook-- " "	1,000.00	
Mortgage Payable		10,000.00
Accounts "		15,600.00
Bank Loans		5,400.00
Land	5,000.00	
Buildings	16,000.00	
Office Fixtures	4,600.00	
Cash	2,360.00	
Petty Cash Fund	100.00	
Accounts Receivable	27,940.00	
Notes Receivable	660.00	
Inventory of Merchandise January 1, 1917	12,800.00	
Sales		68,000.00
Return Sales	2,500.00	
Allowances on Sales	1,300.00	
Freight-Out	200.00	
Purchases	46,000.00	
Freight-In	1,400.00	
Return Purchases		600.00
Clerks' Salaries	6,000.00	
Advertising	1,400.00	
Trimming and Decorating	600.00	
Office Expenses	1,200.00	
Heat and Light	600.00	
Taxes	240.00	
Miscellaneous Expenses	4,500.00	
Interest on Bank Loans	360.00	
Interest on Mortgage	500.00	
Discount on Sales	640.00	
Discount on Purchases		300.00
	$139,900.00	$139,900.00

The inventory of merchandise December 31, 1917, is $11,400. There is also the following inventory of supplies: office supplies $200; coal $50; decorating supplies $150. Clerks' salaries unpaid amount to $230; advertising bills $75; coal and light bills $90; and miscellaneous expense bills $205. None of these bills have been entered on the books due to the system of bookkeeping of not recording expense bills until they are paid.

The following extracts in regard to the division of profits and losses have been taken from the articles of copartnership:

"John Cook shall give his full time and attention to the business and shall be allowed a salary of $7,000 per annum for his services in this respect. John Wahr shall also give his full time and attention to the business and shall be allowed a salary of $2,000 per annum for his services.

"The profits and losses of the business shall be divided in proportion to the capital accounts of the partners at the beginning of each year."

The partners have not drawn their salary for the present year nor has the same been given expression on the books as yet.

All sales are on terms 1% 10 days, net 90 days, and purchases are on practically similar terms.

MISCELLANEOUS QUESTIONS

Question 20--The X Company employs a salesman to whom it has advanced $250 to cover his expenses. The $250 is carried as a working fund. As his expense reports are rendered he is reimbursed for the amount of expenses shown in the report. The fiscal period of the company ends on December 31. In an examination of the books it is found that while an expense report was rendered and received on December 31, no entry thereof was made until January 3, when a check was made out and charged to "Salesmen's Traveling Expenses." State how the matter should have been handled on December 31 in order to state correctly the expenses of that month. Give the journal entries, if any, that would have been necessary.

Question 21--Outline in detail some method of handling cash receipts.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

MARCH 9

Receive 20-day note of George Wilson for $230, bearing interest at 6%, to apply on account. Sale to W. F. Newton of accessories and supplies amounting to $42,000 less 10%, and 5%; terms 1/10, net 30 days.

MARCH 10

Pay bill of New York Auto Supply Co. amounting to $1,350 from which we deduct 1% discount which they have allowed. Give Wilson Manufacturing Co. our 10-day, non-interest-bearing note for $1,600 to apply on account.

MARCH 12

Create a petty cash fund of $100 by drawing a check for that amount in favor of the petty cashier. Give Well-Built Auto Co. our 6% interest-bearing note for 30 days, amounting to $20,000 to apply on invoice No. 7866, and pay balance of this invoice in cash, being allowed 2% discount on balance.

MARCH 14

Receive 20-day non-interest-bearing note of George Wilson for $8,000 in full of account. Frank Rice returns an auto sold him on March 8, sales price $2,000, which we credit to his account. Pay premium of $60 on fire insurance policy for one year from March 1 of this year (charge Unexpired Insurance).

MARCH 15

Sale to Barnhart & Co. of four autos, $16,000, less 10%, 5%, and 10%, terms 1/20, net 60 days. Pay for janitor services, $50 (charge General Expense).

MARCH 17

Pay invoice No. 678, amounting to $12,580, of Wilson Manufacturing Co. less 1% discount. Frank Rice is allowed a rebate of $200 on sale to him March 8, and pays balance of $15,800, less 1% discount allowed to him (charge Auto Rebates and Allowances with rebate of $200).

Solution to Problem 3

(a) Journal entries necessary to record the transfer of assets and liabilities of H. A. Cole to Cole and Nelson:

(1)

Cole and Nelson, Vendee	$94,800.00	
To--Land		$12,000.00
Buildings		13,000.00
Machinery and Tools		12,000.00
Notes Receivable		2,700.00
Customers' Accounts		15,500.00
Cash		2,100.00
Merchandise Inventory		37,500.00
To record transfer of assets to Cole and Nelson		

(2)

Accounts Payable	12,200.00	
Notes Payable	6,000.00	
To--Cole and Nelson, Vendee		18,200.00
To record assumption of liabilities by Cole and Nelson.		

(3)

H. A. Cole--Capital Account	76,600.00	
To--Cole and Nelson, Vendee		76,600.00
To record transfer of capital to Cole and Nelson.		

(b) Journal entries necessary to record the contributions of H. A. Cole and W. H. Nelson to the firm of Cole and Nelson.

(1)

Land	$12,000.00	
Buildings	13,000.00	
Machinery and Tools	12,000.00	
Notes Receivable	2,700.00	
Customers' Accounts	15,500.00	
Cash	2,100.00	
Merchandise Inventory	37,500.00	
To--H. A. Cole--Capital Account		$94,800.00
To record the transfer of assets from the business of H. A. Cole, as per articles of partnership, Section-----		

(2)

H. A. Cole--Capital Account	18,200.00	
To--Accounts Payable		12,200.00
Notes Payable		6,000.00
To record the assumption of liabilities of business of H. A. Cole, as per articles of partnership, Section-----		

(3)

Cash	25,000.00	
Land	4,000.00	
Buildings	20,000.00	
Notes Receivable	6,000.00	
To--W. H. Nelson--Capital Account		55,000.00
To record contribution of W. H. Nelson as per articles of partnership, Section-----		

<u>Solution to Problem 4</u>

(a)

MACK & SCHMIDT

PROFIT AND LOSS ACCOUNT

DEBITS		CREDITS	
Dec. 31, 1917 Expenses (in detail)	$---------	Dec. 31, 1917 Income (in detail)	$---------
Dec. 31, 1917 BALANCE--Net Profit for year carried down	11,000.00		
	$---------		$---------

Dec. 31, 1917 Fred Mack, Salary	$6,000.00	Dec. 31, 1917 Net Profit brought down	$11,000.00
Dec. 31, 1917 John Schmidt, Salary	4,000.00	Dec. 31, 1917 Balance-- Net Loss divided as follows:	
Dec. 31, 1917 Fred Mack, Interest on Capital	4,200.00	Fred Mack $3,100.00	
Dec. 31, 1917 John Schmidt, Interest on Capital	3,000.00	John Schmidt 3,100.00	6,200.00
	$17,200.00		$17,200.00

(b)

STATEMENT OF PARTNERS' CAPITAL ACCOUNTS, DECEMBER 31, 1917

	MACK	SCHMIDT	TOGETHER
Balance, January 1, 1917	$70,000.00	$50,000.00	$120,000.00
Add--Salary	6,000.00	4,000.00	10,000.00
Interest on Capital Invested	4,200.00	3,000.00	7,200.00
	$80,200.00	$57,000.00	$137,200.00
Less--Loss for year	3,100.00	3,100.00	6,200.00
	$77,100.00	$53,900.00	$131,000.00
Less--Withdrawals	4,000.00	5,000.00	9,000.00
Capital Investment, December 31, 1917	$73,100.00	$48,900.00	$122,000.00

ANSWERS TO QUESTIONS

Answer to Question 13--

STATUS OF PARTNERS' CAPITAL ACCOUNTS--DOE AND ROE

	DOE	ROE	TOGETHER
Initial Investment	$10,000.00	$8,000.00	$18,000.00
Profit on Sale of Real Estate	1,000.00	1,000.00	2,000.00
	$11,000.00	$9,000.00	$20,000.00
Loss during year	1,500.00	1,500.00	3,000.00
Balance	$ 9,500.00	$7,500.00	$17,000.00

Answer to Question 14--

Smith--Capital Account	$10,000.00	
To--Cole--Capital Account		$10,000.00

To record sale by Smith of one-half of his interest to Cole, as per articles of partnership of James, Smith and Cole, Section----.

Answer to Question 15--A third interest in the capital of James & Smith has a book value of $10,000. This interest is sold to Cole for $7,000, leaving a loss of $3,000 to be divided between Smith and James in accordance with the profit and loss sharing ratio, viz., Smith 2/3 or $2,000, and James 1/3 or $1,000. The entry required is:

Cash	$ 7,000.00	
Smith--Capital Account	2,000.00	
James--Capital Account	1,000.00	
To--Cole--Capital Account		$10,000.00
To record cash investment of Cole and adjustment of capital accounts in accordance with partnership agreement dated--------.		

Answer to Question 16--A trade discount is the discount to be subtracted from a catalogue or quoted price in order to arrive at the actual selling price. It will not be added back in case a prompt payment is not made. It is used to conceal the cost price from the customer who may examine the catalogue in the dealer's hands; to obviate the necessity of issuing a new catalogue whenever market prices change (since all that need be done is to issue a new trade discount); to permit a ready means of quoting different prices to different dealers, etc. A cash discount is a discount allowed for prompt payment of invoices and may be deducted only if payment is made within the time specified on the invoice.

"7/10 n/60" means that the invoice is payable 60 days from date thereof and that if the payment is made within 10 days from date of invoice a deduction of 7% of the invoice price will be allowed.

The prevailing opinion seems to be that a discount exceeding 2% ten days is a trade discount. Seven per cent would seem to be too large a discount to come under the title of cash discount, even though it could not be deducted if payment were not made within ten days.

Answer to Question 17--

Amount of invoice	$1,000.00
Deduct--30%	300.00
	$ 700.00
Deduct--10%	70.00
	$ 630.00
Deduct--5%	31.50
Net invoice price	$ 598.50
Deduct--2%	11.97
Amount of check sent	$ 586.53

The amount of $598.50 would ordinarily appear on the invoice when issued by the selling company.

CASH

CASH ACCOUNT--Since the cash book is in itself a cash account, a general ledger account with cash is optional. It is preferable, however, to keep a cash account where the cash book is divided into one or more cash receipt books and one or more cash disbursement books, and its advantages are also apparent when taking off trial balances where cash books are not kept by the general ledger-keeper.

PROVING CASH--The cash balance as shown by the cash book should equal the amount in bank plus the amount in cash drawer. The amount in the bank should be detailed in a separate record, or in separate columns in the cash book, which will show deposits and number and amount of checks drawn. At the end of the month the statement received from the bank should be reconciled with the balance in the cash book on the same date. The following statement was prepared September 1, 1917:

A & B
STATEMENT SHOWING RECONCILIATION OF BANK STATEMENT
WITH CASH BOOK, AUGUST 31, 1917

Balance in bank per bank statement dated August 30, 1917			$3,416.73
Add--Deposit made on August 30, 1917, not taken up by bank until September 1, 1917			456.40
			$3,873.13
Deduct--Checks outstanding:			
	NUMBER	AMOUNT	
	512	$16.50	
	515	71.00	
	521	42.30	
	522	1.60	
	523	10.25	
	524	26.60	168.25
Balance as per check stubs			$3,704.88
Add--(1) Bank debit slip #6875--J. J. Smith's check returned marked "N. S. F."			100.00
(2) Cash in cash drawer			417.54
Balance cash on hand and in bank, per cash book			$4,222.42

SAFEGUARDING CASH--The first step in safeguarding cash is to separate the function of receiving cashier from that of paying cashier, the latter making his payments by check, or, in case payments are of a small amount, from a special cash fund kept for that purpose. This separation of function is called the IMPREST system of keeping cash and may be described in further detail as follows:

1. Cash receipts are deposited intact in the bank at the end of each day. The deposits reported by the bank pass-book or by the monthly bank statement may thus be checked in total and in detail with the cash receipts book.

2. Cash disbursements are made by check. The bank statement and cancelled checks may be checked with the cash disbursements book. Thus the cash book becomes a detailed record of bank deposits and withdrawals.

3. Not all cash disbursements can be made by check, however. Stamps, carfare, and small supplies and expenses can be paid for only in currency. For this purpose a PETTY CASH FUND is maintained, the operation of which is described in a subsequent paragraph.

<u>SAFEGUARDING CASH RECEIPTS</u>--The use of cash registers in a retail business assists in safeguarding cash receipts. Each department is provided with one or more cash registers to record cash sales, and total wheels in the register will indicate the receipts for the day which should tally first with the cash in the till and secondly with the cash sales reported by the various salesmen in the department.

In a wholesale business, or in a retail business where checks are received through the mails in payment of accounts, CASH BLOTTERS are usually provided, consisting of a record made by the person or persons opening the mail. This record is checked daily with the cashiers' reports. Cashiers should not be allowed access to blotters, journals, or customers ledgers.

<u>SAFEGUARDING CASH DISBURSEMENTS</u>--Under the imprest system of keeping cash all disbursements are made by check. Even petty cash payments are eventually recorded by check. But the check itself would not constitute an adequate receipt for the payment. There must be a supporting voucher indicating the REASON and DETAIL of the value received, and this voucher should be approved by a responsible official before payment is made. Usually the responsibility of the official signing the check is limited, being confined to noting whether or not the accompanying voucher bears the O K of the proper sub-officials.

<u>PETTY CASH FUND</u>--A petty cash fund is a cash fund kept for the purpose of making small payments which cannot be made conveniently by check, and is operated as follows:

1. A petty cash fund is first created by making out a check for some convenient amount, say $200, and cashing it. The check may be cashed by the receiving cashier or directly at the bank. In case the receiving cashier handles it, he will deposit it along with the other checks and cash making up the receipts even though it is the firm's own check.

2. The amount of the check is debited to a "Petty Cash Fund" account in the general ledger.

3. The $200 will be entrusted to a "petty cashier" who is made responsible for handling it properly and who, upon demand, must show either cash or properly approved vouchers, or both, to make up the total of $200. A petty cash voucher usually consists of a small blank containing spaces for reasons covering payment, signature of person authorizing, and signature of person receiving cash. A PETTY CASH BOOK is usually kept which may consist of a summary of payments only.

4. Whenever the cash on hand in the petty cash fund becomes depleted or nearly so, the petty cashier presents his petty cash book together with supporting vouchers to the proper official. A statement should also be prepared (a "RECAP") showing the accounts to which the disbursements are chargeable. For the purposes of illustration, assume there have been fifty payments amounting to $185 from the fund of $200, chargeable as follows: postage $50; carfare $10; office supplies $100; stationery $25. A check for $185 is issued to the petty cashier and cashed by him in the same manner as the initial check. The amount of the check ($185) is entered in the cash disbursements book and charged to the several accounts indicated by the "recap." Further petty cash payments will be handled in the same way.

5. Whenever financial statements are prepared it is usual to reimburse the petty cashier in full on the closing date so that the balance sheet will show petty cash which consists of actual currency. If, however, he has not been reimbursed at the end of the fiscal period, and if he holds vouchers, as above, amounting to $185, the following journal entry would be made:

-December 31, 1916-		
Postage	$ 50.00	
General Expense (carfare)	10.00	
Office Supplies	100.00	
Stationery	25.00	
To--Petty Cash Fund		$185.00
To record payments from petty cash not taken up on above date.		

On the balance sheet the petty cash will appear as $15. At the beginning of the next month, January 1, 1917, a reversing entry would be made to CREDIT the expense accounts for the amounts with which they are later DEBITED, thus:

-January 1, 1917-		
Petty Cash Fund	$185.00	
To--Postage		$ 50.00
General Expense		10.00
Office Supplies		100.00
Stationery		25.00
To reverse entry made on December 31, 1916.		

The second entry will also restore the petty cash fund account to the original sum; the petty cashier will be reimbursed later in the usual way.

<u>WORKING</u> <u>FUNDS</u>--A WORKING FUND represents cash advanced to an employee or branch office in order that such employee or branch office may make disbursements. It differs from the petty cash fund in that it is not reimbursed for the exact amount of payments made. Cash remittances are made usually in round sums and are charged to the working fund, the latter being credited when reports of payments are made. In case the cashier in charge of the fund receives cash from various sources, the receipts are charged to the fund. In some cases the fund is large enough to warrant part or all of it being kept in a bank account and disbursements made by check.

REFERENCES:
Esquerre, Chapter XIII

COMPLETE ACCOUNTING COURSE--PART I

Lecture 9

CONSIGNMENTS; PROMISSORY NOTES

Problem 7

The consignments-outward record of Chapman and Miner contains the following information regarding shipments made in September, 1917, and shipments made in previous months but not closed out at September 1:

SHIPMENT NUMBER	DATE OF SHIPMENT		COST	CHARGES AMOUNT	CHARGES EXPLANATION	RETURNS DATE		RETURNS AMOUNT	REMARKS
696	Aug.	5	$ 455.00	$ 8.00	Freight	Aug.	8	$ 300.00	Draft
						Sept.	18	275.00	Net Proceeds
699	"	30	780.00	----	----	"	15	821.00	Net Proceeds
801	Sept.	5	660.00	15.00	Freight	"	16	680.00	Net Proceeds
802	"	14	1,540.00	46.00	Freight	"	16	1,000.00	Draft
						"	25	674.00	Net Proceeds
803	"	22	1,056.00	----	----	"	27	800.00	Draft
804	"	25	875.00	16.00	Freight	----		----	

The above record is a memorandum book. Entries are recorded on the general books at the end of each month rather than on the dates on which shipments are made. On the balance sheet prepared August 31 there was shown immediately below the merchandise inventory: "Consignments-Outward, $943.00," and a similar account appears in the general ledger. Freight paid in September has been debited to a Freight account, while the drafts and net proceeds received in September have been credited to an account called "Receipts from Consignments-Outward."

(a) Prepare journal entries necessary to adjust the general records so as to record the above information at September 30, 1917.

(b) What criticism would you offer as to the method of carrying consignments-outward on the balance sheet?

MISCELLANEOUS QUESTIONS

Question 22--On March 30, 1917, the A B Seed Co. consigned to C D, a local retail dealer, 15,200 packages of flower seeds which C D agrees to dispose of at 10 cents per package, the consideration being 20% on the sales. On August 1, 1917, the seed company's traveling representative finds that 2,490 packages remain unsold and these are returned to the A B Co. Prepare an account sales including among the deductions freight paid by the dealer amounting to $4.75.

Question 23--It is the practice in a certain corporation to debit customers' accounts and credit sales account when consignments are shipped. These consignments are not closed out as a rule for several months. Explain in what way, if any, this method of handling consignments would affect the accounts when financial statements are prepared.

Question 24--A promissory note reads as follows:

January 7, 1917.

$1,500.00

Ninety days after date I promise to pay to the order of James S. Lynn Fifteen Hundred Dollars with interest at 6%.

Edward G. Kemp.

Fifteen days after the date of issue J. S. Lynn discounts the note at the bank, the rate of discount being 5%. Compute the proceeds. Also prepare entries necessary to record the transactions on the books of Lynn and Kemp, respectively.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

MARCH 19

Ship W. F. Newton a consignment of four autos, costing us $6,000, to be sold on a commission basis (to be known as Consignment-Outward No. 1). Our non-interest bearing 30-day note for $6,000 is discounted by the bank at 6% (credit Bank Loan account). An allowance is made W. F. Newton, on account of goods returned from shipment of March 9, the list price of the returns being $2,000. He pays the balance of the invoice covering this shipment in cash less a discount of 1%.

MARCH 21

Pay our note for $1,600 dated March 10 in favor of Wilson Manufacturing Co. Sale to Frank Rice of accessories and supplies, $9,400, for which he gives us a 30-day note for $2,400; terms on balance 1/10, net 30 days. We discount the note immediately at the bank at 6%.

MARCH 22

Pay advertising bill for March and April in Automobile Gazette, $350.

MARCH 23

Ship James Garage Co. a consignment of ten automobiles costing us $18,000, to be sold on a commission basis (Consignment-Outward No. 2). Pay freight bill of $300 on above consignment.

MARCH 24

Receive accessories from New York Auto Supply Co., $22,000, invoice 7621, terms 1/15, net 60 days, f.o.b. destination.

MARCH 26

W. F. Newton sends us an account sales on Consignment-Outward No. 1, as follows:

ACCOUNT SALES WITH MILLER BROS.

SALES--4 autos at $2,200 each		$8,800.00
DEDUCT--Storage	$100.00	
Insurance	50.00	
Freight	170.00	
10% Commission	880.00	1,200.00
Net Proceeds		$7,600.00

He does not remit thereon, but agrees to pay in 10 days, which is satisfactory to us.

MARCH 27

We pay freight of $100 on invoice No. 7621 of New York Auto Supply Co. purchased March 24. (Should this be charged to Accessories and Supplies Freight-In or to New York Auto Supply Co.?)

MARCH 29

George Wilson pays his 20-day note received March 9, with interest at 6%, together with his note of March 14.

MARCH 30

Sell E. T. Adams two autos at $2,000 each, and accessories $6,000, total $10,000; terms 1/5, net 60 days.

MARCH 31

Paid for shipping crates and wrapping paper from Chicago Paper Co., bill $1,520 less 1% cash (charge Miscellaneous Selling Expense). We take discount.

Solution to Problem 5

ENTRIES ON BOOKS OF CHICAGO OFFICE

(1)

Evanston Office	$3,500.00	
To--Profit and Loss		$3,500.00
To take up profit reported by Evanston, as per their statement, for year ending July 31.		

(2)

Profit and Loss	9,500.00	
To--A. Stone--Capital account		4,750.00
B. Madison--Capital account		4,750.00
To distribute net profit for year to capital accounts.		

ENTRIES ON BOOKS OF EVANSTON OFFICE

(1)

Merchandise Inventory	$500.00	
To--Chicago Office		$500.00
To take up shipment of merchandise received July 31, but not yet recorded.		

(2)

Profit and Loss	3,500.00	
To--Chicago Office		3,500.00
To transfer net profit for year.		

STONE AND MADISON
CHICAGO AND EVANSTON
BALANCE SHEET, JULY 31, 1917

ASSETS			LIABILITIES		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash	$10,400.00		Accounts Payable		$13,500.00
Accounts Receivable	16,100.00		CAPITAL ACCOUNTS:		
Merchandise	17,500.00	$44,000.00	A. Stone--		
			Balance, August 1, 1916	$20,000.00	
CAPITAL ASSETS:			Profits for year	4,750.00	24,750.00
Land and Buildings	$12,000.00				
Office Fixtures	2,000.00	14,000.00	B. Madison--		
			Balance, August 1, 1916	$15,000.00	
			Profits for year	4,750.00	19,750.00
		$58,000.00			$58,000.00

ANSWERS TO QUESTIONS

<u>Answer to Question 18</u>--

(a) A method that may be used is as follows:

CASH RECEIPTS BOOK

DATE	PARTICULARS	FOLIO	GENERAL LEDGER	CUSTOMERS LEDGER	DISCOUNT ON SALES	BANK DEPOSITS
-	- - - - - - - -	- -	- -	- -	- -	- -
-	- - - - - - - -	- -	- -	- -	- -	- -
31	General Ledger (already posted)	- -	$10,000.00	$50,000.00	$550.00	$64,350.00
31	Customers Ledger Cr.	321	50,000.00			
			$60,000.00			
31	Discount on Sales Dr.	982	550.00			
			$59,450.00			
31	Balance on hand May 1	- -	4,900.00			
			$64,350.00			$64,350.00

CASH DISBURSEMENTS BOOK

DATE	PARTICULARS	FOLIO	GENERAL LEDGER	CREDITORS LEDGER	DISCOUNT ON PURCHASES	BANK WITHDRAWALS
-	- - - - - - - -	- -	- -	- -	- -	- -
-	- - - - - - - -	- -	- -	- -	- -	- -
31	General Ledger (already posted)	- -	$23,000.00	$40,000.00	$600.00	$62,400.00
31	Creditors Ledger Dr.	501	40,000.00			
			$63,000.00			
31	Discount on Purchases Cr.	881	600.00			
			$62,400.00			
31	Balance on hand May 31	- -	1,950.00			1,950.00
			$64,350.00			$64,350.00

(b) Journalizing the totals of a book of original entry is generally considered unnecessary. Some bookkeepers claim in support of the practice that all the entries going into the ledger should appear in the general journal; but where the "General Ledger" or "Sundry" column contains many items, their transfer to another journal would seem to involve a large amount of duplication.

Answer to Question 19--Each item entered in the cash disbursement book will be a credit to cash and a debit to some account indicated by the entry. The credit will be made to the cash account at the end of the month by posting thereto the total of the cash payments during that month. As for the debits, the total of the general ledger column will not be posted since the details have already been debited to accounts in the general ledger; the total of the creditors ledger column will be posted to the debit of the creditors ledger controlling account in the general ledger since the details have been posted during the month only to the subsidiary ledger. The total of the discounts on purchases will be posted as a credit to the proper account in the general ledger since the discount has been added to the actual payments in order that the gross amount might be debited to the creditors' accounts. The amount to be posted to the credit of the cash account will be ascertained by adding the total of the general ledger column to the total of the creditors ledger column and subtracting the total of the discounts on purchases account therefrom.

CONSIGNMENTS

DEFINITION--A consignment is a shipment of goods from one party to another, the latter acting as the agent of the shipper in disposing of them. The shipper of the goods is called the CONSIGNOR and the recipient the CONSIGNEE or COMMISSION MERCHANT. The last term is generally confined to the produce and grocery business.

SETTLEMENT BY CONSIGNEE--When the goods shipped are disposed of by the consignee, he is required to remit the proceeds to the shipper or consignor. His commission for making the sale is usually a stated percentage of the gross sales, and before remitting he is entitled to deduct such commission together with other expenses incurred in selling the goods. The amount sent the shipper is termed the NET PROCEEDS from the sale, while the accompanying statement showing the selling price to customers and the deductions is called the ACCOUNT SALES (meaning "an account of sales"). Settlements are made periodically on the portion sold up to the end of a fiscal period, or after the entire lot has been disposed of, depending on the agreement in force.

SELLING PRICE--Often the selling price is fixed by the consignor, and if the consignee sells for less there must be some special reason or he may be held liable to the consignor for the agreed price. In other cases, as in shipment of produce, the selling price cannot be fixed by the consignor but depends on daily market quotations or perhaps even on prices guaranteed by the consignee.

DISTINCTION BETWEEN CONSIGNMENT AND SALE--When the price has been fixed or guaranteed, it would seem that the consignment has become a sale. But there is always a legal, and usually a practical, distinction. In a sale, ownership as a rule passes with the shipment of the goods, while consigned goods remain in the shipper's ownership until his agent, the consignee, has sold them. The consignee cannot treat the merchandise as his own; i.e., he cannot dispose of it except as directed by the consignor and cannot make it a security for his personal debts, etc. A second distinction has already been indicated--the manner of payment. A consignment usually does not have to be paid for until the goods are sold, while goods purchased must be paid for whether sold or not.

A consignee who guarantees the accounts with his customers is said to be a DEL CREDERE AGENT.

ACCOUNT SALES--The following is a typical account sales rendered by a commission merchant:

	O. B. FOX, Consignee,	April 4, 1917.	
Stencil 5476	in account with		
Lot No. 87934	H. W. DUNNE, Consignor		
GROSS SALES--40 boxes celery at $1.15			$46.00
DEDUCT--Freight		$3.45	
Cartage		.80	
Storage (1¢ per box per day for 3 days)		1.20	
Discount		.92	
Commission		3.22	9.59
NET PROCEEDS (check enclosed)			$36.41

DEDUCTIONS--Commission is usually the most important deduction from the amount to be remitted by the consignee to the consignor. Other deductions commonly include freight, drayage, storage, and discount. The last-named expense refers to the cash discount taken by the customers of the consignee. Thus, if the terms given customers are 2/10, n/30, the consignee may, with the consent of the shipper, deduct 2% from the gross sales reported in order to protect himself against loss. In some cases a part of the selling expenses may be deducted, but usually the commission allowed is expected to cover such expenses. The deductions to be made are a matter of agreement between the two parties before the shipment is made, or they are governed by trade customs.

CONSIGNMENTS-OUTWARD--The term "consignment" if used alone generally refers to a "consignment-inward," while a "shipment" refers to a "consignment-outward." To avoid confusion it is best to use the terms "consignments-inward" and "consignments-outward." A discussion of consignments-inward will be found in I-11-10.

When a consignment is shipped, title to the goods remains in the shipper. Legally, the goods still "belong" to him, but a practical consideration of the matter--namely, that the goods have been shipped from one business to another--has often led to confusion in determining what accounts should be debited and credited to record the transaction. It would not seem justifiable to credit sales and debit a customer's account when there is no sale and no customer. A simple method which may be used by a business shipping but few consignments is illustrated below. This method makes necessary two new ledger accounts: "Consignment Stock Outward" and "Profits on Consignments-Outward." For the purposes of illustration, assume that the celery in the account sales appearing above was purchased by the consignor, H. W. Dunne, at a cost of 80 cents per box--total $32. When the shipment was made to the consignee the following entry would appear in the journal:

(1)
-April 2, 1917-

Consignment Stock Outward	$32.00	
To--Purchases		$32.00
Shipment to O. B. Fox of 40 boxes celery costing 80 cents per box.		

In case the consignor pays freight or other charges on the consignment, the amount of such payments is debited to the Consignment Stock Outward account.

When the net proceeds are received cash will be debited and Consignment Stock Outward account credited. It will be noted that the ACTUAL sales price to the customer of the consignee is not taken up on the books of the consignor. Neither are the expenses and commission deducted by the consignee taken into the accounts. The selling price to the consignor is the net proceeds remitted by the consignee, viz.:

(2)
-April 4, 1917-

Cash	$36.41	
To--Consignment Stock Outward		$36.41
Net Proceeds in full on shipment made on April 2, 1917 to O. B. Fox. (This entry will appear in the cash book.)		

As each consignment is closed, or at the end of the month or fiscal period, the cost of the consignments closed out will be balanced against the sales, and the difference transferred to Profits on Consignments-Outward account. The latter account will then be closed into Profit and Loss when the books are closed.

(3)
-April 4, 1917-

Consignment Stock Outward	$4.41	
To--Profits on Consignments-Outward		$4.41
To transfer profit on consignment-outward sale.		

(4)
-April 30, 1917-

Profits on Consignments-Outward	4.41	
To--Profit and Loss		4.41
To transfer profits for month on sales of consignment-outward.		

The use of the two accounts may be summed up in the following:

CONSIGNMENT STOCK OUTWARD

DEBIT	CREDIT
With cost of shipments to consignee at the same time crediting purchases account. With all charges paid by the consignor such as freight, insurance, etc. At the end of a fiscal period, or as consignments are closed out, with the net profits earned, at the same time crediting Profits on Consignments-Outward.	With proceeds from all consignments, the contra debit being cash or consignee's personal account.

The balance of this account shows the cost to date of all consignments-outward not closed out, and will appear on the balance sheet with merchandise inventory.

PROFITS ON CONSIGNMENTS-OUTWARD

DEBIT	CREDIT
	At the end of a fiscal period, or as the consignments are closed out, with the net profits earned, at the same time debiting Consignment Stock Outward.

The balance of this account will be the profit or loss on consignments-outward closed out during the period, and will be transferred to Profit and Loss account. In the statement of profits and income this profit or loss is shown as an addition to or deduction from gross profit from sales, since it is clearly an operating profit or loss.

A consignments-outward ledger may be kept in case the number of shipments is very large. This might consist of copies of invoices sent with the consignments, and all charges and credits would be entered against the proper consignment. At the end of the month or fiscal period the consignments closed out would be removed from the ledger and proper entries made debiting or crediting Profit and Loss account. A controlling account is provided in the general ledger.

Other methods of handling consignments-outward may be used depending upon (1) the nature of the business, (2) the character of the accounting system, and (3) the kind of data desired by the management.

PROMISSORY NOTES

DEFINITION--COMMERCIAL PAPER is divided broadly into two classes: PROMISSORY NOTES and BILLS OF EXCHANGE. The latter will be discussed in I-12-8. A promissory note is defined by the uniform negotiable instruments act as "an unconditional promise in writing, made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to the bearer." A promissory note is a NOTE PAYABLE to the person issuing it and a NOTE RECEIVABLE to anyone, except the maker, receiving it.

PARTIES--There are two parties to a promissory note: the MAKER and the PAYEE. There may be also one or more sureties and one or more indorsers.

ACCOUNTING FOR PROMISSORY NOTES--It is unnecessary to maintain a separate record where only a few notes are received or issued. The explanation column in the Notes Receivable or Notes Payable account may be used to record the essential data for each note. Where many notes are handled, a notes receivable register and a notes payable register are necessary. The two registers are practically alike and contain columns to record date received (or issued); date of note; name of maker; name of indorser; where payable; time; interest rate; followed by twelve columns for months (the day on which the note matures being entered in the column of the month of maturity); date of payment; remarks. The note registers may be used as books of original entry, or may be treated as subsidiary ledgers, with a controlling account in the general ledger.

NOTES RECEIVABLE DISCOUNTED--The indorsement of notes which are discounted creates a liability of the indorser to subsequent holders, known as a CONTINGENT LIABILITY. This means that in case the maker of the note fails to pay when the note is due, the liability of the indorser is likely to become a real one. For that reason it is often desirable to credit the receipts from discounted notes to a NOTES RECEIVABLE DISCOUNTED account instead of Notes Receivable account. When the indorser is notified of the payment of the note, the credit is transferred to the Notes Receivable account. The following journal entries will illustrate.

(1)
-September 1-

Notes Receivable	$500.00	
To--J. P. Scott		$500.00
To record receipt of 30-day non-interest-bearing note in settlement of his account.		

(2)
-September 15-

Cash	498.75	
Interest Prepaid	1.25	
To--Notes Receivable Discounted		500.00
J. P. Scott's 30-day non-interest-bearing note discounted at 6%.		

(3)
-September 30-

Notes Receivable Discounted	500.00	
To--Notes Receivable		500.00
J. P. Scott's note of September 1, paid at First National Bank.		

Suppose, however, that J. P. Scott failed to pay the note when due and that the indorser was forced to pay the amount to the bank. In place of entry (3) above would appear the following entries:

(3)
-October 5-

Notes Receivable Discounted	$500.00	
To--Cash		$500.00
J. P. Scott's 30-day note protested.		

(4)
-October 5-

J. P. Scott	500.00	
To--Notes Receivable		500.00
To charge back protested note to customer's account.		

In case there were protest fees, these too would be charged to the customer's account.

NOTES RECEIVABLE DISCOUNTED ON THE BALANCE SHEET--There are four methods in common use for handling discounted notes on the balance sheet:

1. Among current assets:

Notes Receivable	$7,600.00	
Less--Notes Receivable Discounted	1,900.00	$5,700.00

2. Among current liabilities similar to other current liabilities. (Notes Receivable would appear at the gross figure, $7,600.)

3. Among current liabilities but "carried short:"
Notes Receivable Discounted $1,900.00

The amount would not be extended and consequently would not appear in the total of current liabilities. (Notes Receivable would appear at the net figure, $5,700.)

4. As a footnote to the balance sheet. (Notes Receivable would appear at the net figure, $5,700.)

Method No. 2 would ordinarily be used only where there is some likelihood that the discounted notes would not be met by the makers.

REFERENCES:
Cole, pages 381-4
Gilman, pages 165-6; 200-202
Esquerre, pages 208-220; 158-163
Greendlinger and Schulze, pages 356, 357, 360-362

COMPLETE ACCOUNTING COURSE--PART I

Lecture 10

JOINT VENTURES; ACCRUING INCOME AND EXPENSE; DEFERRED CHARGES AND CREDITS

Problem 8

Plant & Co. and Edwards & Co. ship merchandise to South America on joint account. Edwards & Co. give Plant & Co. $1,200 in cash and their note for $3,000 in lieu of cash. Plant & Co. are to provide the balance of cash required, to manage the venture, and to receive a commission of 2% on amount of invoice for merchandise. Profits to be divided equally.

Plant & Co. paid Smith & Greer $5,000 for merchandise and discounted Edwards & Co.'s note of $3,000 at a cost of $60. Plant & Co. prepaid freight $420, insurance $60. In due time Plant & Co. received from South America an account sales and a draft for the net proceeds, payable in London for $3,200, out of which Plant & Co. paid $3,000 to retire the note of Edwards & Co.

Later Plant & Co. received draft for $3,100, being balance of proceeds of sale of merchandise. The joint account with Edwards & Co. was closed and a check for the balance due was paid to Edwards & Co.

Prepare statement showing details of the joint account, also a statement of Edwards & Co.'s account.

Problem 9

The following comprise the nominal accounts of the Empire Trading Co. at October 31, 1917:

	DEBITS	CREDITS
Rent	$1,650.00	
Taxes	2,200.00	
Salaries	11,675.00	
Insurance Expired	1,180.00	
Heating and Lighting	3,540.00	
Inventory--Silks, November 1, 1916	18,140.00	
Purchases--Silks	57,165.00	
Freight-In--Silks	1,798.00	
Inventory--Linens, November 1, 1916	22,900.00	
Purchases--Linens	44,462.00	
Freight-Out--Linens	1,520.00	
Allowances and Returns--Silks	2,970.00	
Allowances and Returns--Linens	2,515.00	
Discounts on Sales--Linens	4,115.00	
Interest paid	575.00	
Sales--Silks		$82,476.00
Sales--Linens		85,144.00

The inventories on October 31, 1917, are silks $19,475, and linens $8,460. On the same date unpaid invoices amount to $2,515, and are classified as follows:

Purchases--Silks	$2,145.00
Rent	150.00
Insurance (of which $135 has expired)	220.00
Total	$2,515.00

Neither taxes accrued $200, nor accrued interest on notes payable $140, have been taken up on the books. Formulate the entries necessary to adjust and close the books of the concern on October 31, 1917.

MISCELLANEOUS QUESTIONS

Question 25--The Acme Club initiates new members on January 1, April 1, July 1, and October 1 of each year and dues for one year in advance are payable on the day of initiation. On the liability side of the balance sheet prepared December 31, 1916, appears the following item: "Membership Dues Unearned, $7,172.50." During the year 1917 entries were made charging members' accounts and crediting "Income from Membership Dues" as follows: January 1, $8,750; April 1, $6,100; July 1, $2,550; October 1, $6,400. What adjusting entries must be made on December 31, 1917, to state properly the gross income from membership dues for the fiscal year ending that date?

Question 26--

(a) What is the due date of the note appearing in Question 24?

(b) Of a note dated January 7 and due "three months from date"?

(c) Should the 360- or 365-day year be used in interest calculations?

WORK TO BE DONE IN THE PRACTICE SET

Close and post the books of original entry. Be sure all individual postings have been made. Then prepare a schedule of customers and creditors ledger accounts, the totals of which should agree with the respective controlling accounts. Prepare and submit trial balance of the general ledger.

Financial statements will not be prepared at March 31, and the nominal accounts will not be closed until April 30.

Solution to Problem 6 — Exhibit A

WAHR AND COOK

BALANCE SHEET, DECEMBER 31, 1917

ASSETS			LIABILITIES AND CAPITAL		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash	$2,360.00		Accounts Payable		$15,970.00
Petty Cash Fund	100.00	$2,460.00	Bank Loans		5,400.00
			Salaries Unpaid		230.00
Notes Receivable		660.00			
Accounts Receivable		27,940.00	Total Current Liab.		$21,600.00
Inv.--Merch.	$11,400.00		MORTGAGE		10,000.00
Sundry Supp.	400.00	11,800.00			
			CAPITAL ACCOUNTS:		
Total Current Assets		$42,860.00	(Details in		
CAPITAL ASSETS:			Exhibit C)		
Land	$5,000.00		Wahr	$23,145.00	
Buildings	16,000.00		Cook	13,715.00	36,860.00
Office Fixtures	4,600.00	25,600.00			
			Total Liabilities		
Total All Assets		$68,460.00	and Capital		$68,460.00

Exhibit B

WAHR AND COOK
STATEMENT OF PROFITS AND INCOME
YEAR ENDING DECEMBER 31, 1917

Particulars			Amount	Per-centage
GROSS SALES			$68,000.00	106.3%
Deduct--Return Sales		$2,500.00		
Allowances on Sales		1,300.00		
Freight-Out		200.00	4,000.00	6.3
NET SALES			$64,000.00	100.0
COST OF MERCHANDISE SOLD:				
Inventory, January 1, 1917		$12,800.00		
Purchases	$46,000.00			
Freight-In	1,400.00			
	$47,400.00			
Return Purchases	600.00	46,800.00		
		$59,600.00		
Inventory, December 31, 1917		11,400.00	48,200.00	75.3
GROSS PROFIT FROM SALES			$15,800.00	24.7
SELLING AND GENERAL EXPENSES:				
Clerks' Salaries		$6,230.00		9.7
Advertising		1,475.00		2.3
Trimming and Decorating		450.00		.7
Office Expenses		1,000.00		1.6
Heat and Light		640.00		1.0
Taxes		240.00		.4
Miscellaneous Expenses		4,705.00		7.4
Partners' Salaries		9,000.00		14.0
Total			23,740.00	37.1
NET LOSS FROM OPERATION			$7,940.00	12.4
Deduct--Discounts on Purchases			300.00	.4
			$7,640.00	12.0
Add--Interest Paid		$860.00		
Discounts on Sales		640.00	1,500.00	2.3
NET LOSS carried to Proprietors' accounts			$9,140.00	14.3
Distributed as follows:				
Wahr ¾		$6,855.00		
Cook ¼		2,285.00		
Total		$9,140.00		

WAHR AND COOK
STATEMENT OF PARTNERS' CAPITAL ACCOUNTS
DECEMBER 31, 1917

	WAHR	COOK	TOGETHER
Balance, January 1, 1917	$30,000.00	$10,000.00	$40,000.00
Salary for year	2,000.00	7,000.00	9,000.00
	$32,000.00	$17,000.00	$49,000.00
Loss for year as above	6,855.00	2,285.00	9,140.00
	$25,145.00	$14,715.00	$39,860.00
Withdrawals during year	2,000.00	1,000.00	3,000.00
Balance, December 31, 1917 (Exhibit A)	$23,145.00	$13,715.00	$36,860.00

JOURNAL ENTRIES TO CLOSE THE BOOKS
OF WAHR AND COOK, DECEMBER 31, 1917

(1)

Clerks' Salaries	$230.00	
Advertising	75.00	
Heat and Light	90.00	
Miscellaneous Expense	205.00	
To--Salaries Unpaid		$230.00
Accounts Payable		370.00

To record liabilities not taken up on books.

(2)

Sundry Supplies	400.00	
To--Office Expenses		200.00
Heat and Light		50.00
Trimming and Decorating		150.00

To take up inventory of sundry supplies.

(3)

Partners' Salaries	9,000.00	
To--Cook--Drawing Account		7,000.00
Wahr--Drawing Account		2,000.00

To set up partners' salaries as per partnership agreement.

(4)

Cost of Sales Account		$1,400.00	
To--Inventory of Merchandise			$1,400.00
To record decrease in merchandise inventory as follows:			
January 1, 1917	$12,800.00		
December 31, 1917	11,400.00		
Decrease	$1,400.00		

(5)

Sales	4,000.00	
To--Return Sales		2,500.00
Allowances on Sales		1,300.00
Freight-Out		200.00
To transfer deductions from sales to sales account.		

(6)

Purchases	800.00	
Return Purchases	600.00	
To--Freight-In		1,400.00
To transfer to Purchases account deductions and additions thereto.		

(7)

Cost of Sales Account	46,800.00	
To--Purchases		46,800.00
To transfer net purchases.		

(8)

Sales	64,000.00	
To--Cost of Sales account		48,200.00
Profit and Loss		15,800.00
To transfer gross profit to Profit and Loss account.		

(9)

Profit and Loss	23,740.00	
To--Clerks' Salaries		6,230.00
Advertising		1,475.00
Trimming and Decorating		450.00
Office Expenses		1,000.00
Heat and Light		640.00
Taxes		240.00
Miscellaneous Expenses		4,705.00
Partners' Salaries		9,000.00
To transfer expense accounts to Profit and Loss account.		

(10)

Discounts on Purchases	$300.00	
To--Profit and Loss		$300.00
To transfer miscellaneous income.		

(11)

Profit and Loss	1,500.00	
To--Interest Paid		860.00
Discounts on Sales		640.00
To transfer non-operating expenses.		

(12)

Wahr--Drawing Account	6,855.00	
Cook--Drawing Account	2,285.00	
To--Profit and Loss		9,140.00
To transfer net loss for year to drawing accounts.		

(13)

Wahr--Capital Account	6,855.00	
Cook--Drawing Account	3,715.00	
To--Wahr--Drawing Account		6,855.00
Cook--Capital Account		3,715.00
To transfer balances of drawing accounts to capital accounts.		

ANSWERS TO QUESTIONS

Answer to Question 20--An adjusting journal entry should have been made crediting the working fund with the amount of the salesman's expense report and debiting the proper selling expense account, thus:

Salesman's Traveling Expenses	$195.00	
To--Advances to Salesman		$195.00
To take up expense report of ...., dated December 31, 1917.		

The effect of not making this adjusting entry would be to overstate both assets and profits. The entry having been made, Advances to Salesman will appear as $55 on the balance sheet.

Answer to Question 21--All mail is opened in the mailing department for distribution purposes. If a remittance is enclosed, the amount thereof is noted on the envelope and the envelope together with the remittance is sent to the cashier's office. The letter is sent to the proper correspondent for acknowledgment. The cashier writes up his cash book directly from the remittances and deposits intact the entire receipts for the day. The cash receipts are posted by the ledger-keepers. The ledger-keepers have no access to the cashier's cage, nor has the cashier access to the ledgers.

A further development involves the preparation by the mail department of an itemized list of remittances received showing name, address, amount, etc. The original is sent to the cashier with the remittances and will be used as the basis for the cash book entries. The duplicate is sent to the general bookkeeper and may be used to check the daily bank deposit. The triplicate is retained in the mail department as a record of the items there received and forwarded to the cashier.

JOINT VENTURES

A joint venture has already been referred to as a special partnership; it is a temporary partnership formed for the purpose of dividing the risk of selling a particular lot of goods, as where shipment is made to a distant point. The shipment is often a consignment. Thus, A is a dealer known to B but unknown to C and desires to obtain a certain lot of goods from C. B arranges with C to send the merchandise to A on JOINT ACCOUNT, he (B) agreeing to collect the proceeds when the goods are sold. B and C are called the VENTURERS or ADVENTURERS, and A the consignee. An agreed rate of interest may be allowed or charged as between the adventurers on all amounts advanced or received up to the date of settlement. Profits or losses are computed in the ordinary way, the basis of division depending on agreement.

The accounts of the venture are kept on the books of one of the venturers called the MANAGER. A Joint Venture account is debited with all advances and credited with all receipts applicable to the venture. If others of the venturers make advances or take over part of the receipts, personal accounts should be opened with them on the books of the manager in order to show the proper amounts as contra entries in the Joint Venture account. When the transactions concerning the venture have been completed, immediate settlement is made and Venture account and personal accounts with venturers closed out.

ACCRUING INCOME AND EXPENSE

Before a statement of profit and loss and a balance sheet are prepared, care should be taken to see that all assets and liabilities and all income and expense appear on the books. Items such as wages, rent, royalties, interest, taxes (income and property taxes), etc., should be ACCRUED, i.e., set up on the books whether receivable or payable, and whether due or not due. The necessary journal entries may be described as follows: (1) for accruing income, debit an Accruing Asset account and credit an Income account; (2) for accruing expense, debit an Expense account and credit an Accruing Liability account. The fact that such assets and liabilities may not be receivable or payable until some future time does not alter the necessity for stating properly the income and expense of the period under review and of indicating the correct financial position at a certain date.

<u>ACCRUED INTEREST ON NOTES RECEIVABLE</u>--This item is an asset appearing on the balance sheet, sometimes following Notes Receivable. To ascertain the amount of interest accrued, the notes on the notes receivable register should be examined and the interest on each note computed up to the date of the balance sheet. If the accrued interest is found to be, say, $650, the following journal entry may be made:

-December 31, 1916-

Accrued Interest on Notes Receivable	$650.00	
To--Interest Received (or Earned)		$650.00

To take up interest accrued to December 31,1916, as per schedule.

The account credited is termed Interest Received or Interest Earned. It is usually unnecessary to distinguish between interest actually received and interest merely accrued. In the ordinary course of business transactions the accrued income will soon be realized and need not therefore be brought out separately.

After the accrued interest has been set up on the ledger it is of importance to see how the account will be handled during the following accounting period. Two methods are in common use.

1. At the end of each month the notes receivable should be examined for the purpose of ascertaining the amount of interest accrued thereon during that month, whether such interest has been paid out or not. Thus, during January, 1917, if interest has accrued to the amount of $875, a journal entry debiting Accrued Interest and crediting Interest Earned will be made:

-January 31, 1917-

Interest Accrued on Notes Receivable	$875.00	
To--Interest Earned		$875.00
To record interest earned during January as per schedule.		

Assume that during the month $800 in payment of interest has been received.

Cash	$800.00	
To--Interest Accrued on Notes Receivable		$800.00
(The entry will be made through the cash book when the interest is received.)		

If the interest accrued at the beginning of the month was $650, the balance of the account will stand at $725, which should be the amount accrued and outstanding at January 31.

INTEREST ACCRUED ON NOTES RECEIVABLE

DEBIT WITH	CREDIT WITH
Interest accrued and outstanding at beginning of month.	Interest paid, at the same time debiting cash.
Interest earned during each month, at the same time crediting Interest Earned (a profit and loss account).	

The balance of the account is an asset, being the interest accrued and outstanding at the end of the period.

The Interest Received or Interest Earned account will contain but one entry (a credit corresponding to the second debit in the Interest Accrued account), and will be an Income account to be closed into Profit and Loss.

2. The first method rests on the theory that all interest on notes receivable when paid has been previously accrued and is therefore to be posted from the cash book to the credit of the Interest Accrued account even though the accrued interest will not be set up on the books until the end of the month. A second method treats all interest received as income, adjustments to be made at the end of the month or period. The three entries described above will be altered as follows:

(1)

-January 31, 1917-

Cash	$800.00	
To--Interest Received		$800.00
(This entry will be made in the cash book whenever the interest is received.)		

(2)

Interest Received	$650.00	
To--Interest Accrued on Notes Receivable		$650.00
To reverse entry made on December 31, 1916. (This reversing entry may have been made on January 1, 1917.)		

(3)

Interest Accrued on Notes Receivable	725.00	
To--Interest Received		725.00
To take up interest accrued at January 31, 1917.		

(4)

Interest Received	875.00	
To--Profit and Loss		875.00
To close out interest earned during January.		

INTEREST ACCRUED ON NOTES RECEIVABLE

DEBIT WITH	CREDIT WITH
Interest accrued and outstanding at beginning of period. Interest accrued and outstanding at end of period, at the same time crediting Interest Received.	The amount of the interest accrued and outstanding at the beginning of the period, at the same time debiting Interest Received.

The balance of the account is the interest accrued and outstanding at the end of the period and is an asset.

INTEREST RECEIVED

DEBIT WITH	CREDIT WITH
At the end of the period the amount of interest accrued and outstanding at the beginning of the period, at the same time crediting Interest Accrued.	Receipts of interest, at the same time debiting cash. Interest accrued and outstanding at end of period, at the same time debiting Interest Accrued.

The balance of the account is the interest earned during the period (a credit) and will be closed out to Profit and Loss.

INTEREST ACCRUED ON NOTES PAYABLE--What has been said concerning interest accruing on notes receivable applies as well to interest accruing on notes payable, the situation being, of course, reversed. Either method described above may be used, the accounts involved being Interest Paid (or Interest Expense) and Interest Accrued on Notes Payable.

WAGES ACCRUED--Accrued wages are usually definitely ascertainable and may be put on the books of account by debiting Wages and crediting Wages Accrued, the latter appearing on the balance sheet as a current liability. On the first day of the period following, the entry may be reversed, as in the case of Method 2. Or, following the first method, all payments to wages may be regarded as the payment of a liability already accrued and thus debited to Wages Accrued account.

TAXES ACCRUED--In handling taxes, the first of the two methods suggested is nearly always used. Taxes are looked upon as accruing from month to month, although paid usually but once a year. At the end of each month or other accounting period, Taxes account is debited and Taxes Accrued account is credited with the amount estimated to apply to that period. Both property and income taxes should be accrued, the former being computed on the basis of last year's taxes or other information available, and the latter on the basis of the income for the period.

In the case of property taxes, the rate being subject to change each year, the exact amount to be accrued each month cannot be ascertained. In this respect taxes differ from other accruing items described. Unless other information is available, the best plan is to set up the liability on the basis of the previous year's taxes and if the actual assessment differs from the liability thus provided, the difference, if small, may be absorbed in the expenses of the last month of the fiscal period. If the difference is a large one, the Profit and Loss account of the period to which the taxes apply may have to be adjusted.

TAXES ACCRUED

DEBIT WITH	CREDIT WITH
Taxes paid, at the same time crediting cash.	Monthly proportion of estimated accruing taxes, at the same time debiting Taxes (a nominal account).

The balance of the account is a credit and represents the taxes accrued and unpaid at the end of each monthly period.

The Taxes account is an expense account which will be debited monthly with the proportion of estimated taxes applicable thereto (at the same time crediting Taxes Accrued), and will be closed out to Profit and Loss.

DEFERRED CHARGES TO EXPENSE AND DEFERRED CREDITS TO INCOME

The preceding paragraphs describing accrued income and expenses may be contrasted with the following discussion of DEFERRED CHARGES and DEFERRED CREDITS. Both have to do with cash receipts on account of income and cash payments on account of expense which lie outside the fiscal period under review. In the case of accrued items the cash receipt or cash payment will be made in the future; in the case of deferred items the cash receipt or cash payment has been made in the past. Moreover, both have the same purpose: to facilitate the preparation of a correct statement of financial position and of profits.

Illustrations of Deferred Charges are: (1) prepayments of various expenses, such as interest, rent, insurance, advertising, taxes, etc.; (2) discounts sustained on securities issued; and (3) extraordinary losses or other expenses which may not be of benefit to future periods, but which are of such a nature that to carry them at once to profit and loss might unduly depress the current earnings, such as extraordinary repairs where no depreciation has been provided, or flood expenses. Classes (2) and (3) will be taken up later.

PREPAID INTEREST--When notes receivable are discounted, the discount sustained is really prepaid interest, which should be spread over the term of the note. It is usual, therefore, to debit an asset account, Prepaid Interest on Notes Receivable Discounted, at the time the notes are discounted. When the books are closed, only that amount applying to the period subsequent to the closing date should be left in the account, the balance being carried to Profit and Loss through the medium of the Interest Paid account.

(1)
-October 1, 1917-

Cash	$ 970.00	
Prepaid Interest	30.00	
To--Notes Receivable Discounted		$1,000.00
To record discounting of Geo. Smith's six months' non-interest-bearing note dated October 1, discount rate 6%.		

(2)
-December 31, 1917-

Interest Paid	15.00	
To--Interest Prepaid		15.00
To transfer portion of prepaid interest expired.		

PREPAID INSURANCE--The premium on insurance is paid in advance and may therefore be debited at once to an asset account, Prepaid Insurance. Where a large number of policies are held, it is convenient to keep a memorandum record of each premium paid in what is called an "insurance register." If the books are closed monthly, a separate money column is provided for each month so that the amount expiring during each month may be ascertained for the purpose of making a journal entry, crediting Prepaid Insurance and debiting Insurance (a profit and loss account).

DEFERRED CHARGES ON THE BALANCE SHEET--Prepaid expenses are sometimes included under the caption of WORKING ASSETS, representing expenditures necessarily incident to the earning of future income. For the present they may be shown under a separate caption, "Prepaid Expenses," following current assets.

DEFERRED CREDITS TO INCOME--In the ordinary trading or manufacturing business, deferred credits are uncommon. A club may have a deferred credit appearing on its balance sheet consisting of dues paid in advance. Other illustrations are Subscriptions Unearned in the case of newspapers and magazines and Prepaid Water Rentals in the case of waterworks. In any case a deferred credit is treated similar to a deferred charge; carried on the balance sheet as a separate item following current liabilities, and written off to the credit of Profit and Loss when earned.

REFERENCES:
Cole, pages 42-45
Esquerre, pages, 315-316; 363-368
Greendlinger and Schulze

COMPLETE ACCOUNTING COURSE--PART I

Lecture 11

CONSIGNMENTS-INWARD

Problem 10

The balance sheet of A. R. Miles and Co., commission merchants, on October 1, 1917, was as follows:

ASSETS			LIABILITIES		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash	$14,167.40		Freight unpaid	$ 86.20	
Accounts Rec.	8,488.23		Due on Consignments not closed out	2,787.96	$ 2,874.16
Advances on Consignments	3,176.14	$25,831.77			
PREPAID EXPENSE:					
Insurance		485.00			
CAPITAL ASSETS:			CAPITAL ACCOUNT:		
Furniture and Fixtures		2,000.00	Balance, Sept. 1, 1917	$24,347.80	
			Profits for September (including $476.49 a gross profit on consignments not closed out)	1,094.81	25,442.61
		$28,316.77			$28,316.77

The consignments-inward ledger contained the following details at October 1, 1917:

CONSIGNMENT NUMBER	ADVANCES			COMMISSION EARNED		TOTAL OF ADVANCES AND COMMISSION	SALES
	FREIGHT	DRAYAGE	DRAFTS	RATE	AMOUNT		
1196	$34.50	$ 5.25	$4,000.00	5%	$ 68.52	$4,108.27	$1,370.50
1200	19.40	4.00	--------	10%	254.70	278.10	2,547.00
1201	7.25	3.50	1,000.00	10%	63.60	1,074.35	635.98
1204	10.10	2.00	500.00	8%	89.67	601.77	1,120.83
	$71.25	$14.75	$5,500.00	---	$476.49	$6,062.49	$5,674.31

On October 31, 1917 the only consignment not closed out was No. 1196. During the month additional sales of $4,451 were made from this consignment but no further advances were made thereon.

Duplicate invoices are the only records kept of sales to customers, and as these are paid promptly and individually, there is no need for a customers ledger. There is also no general ledger.

The following consignments were handled and closed out during October, settlements being made in cash, the information being taken from the consignment sheets filed away during the month.

CONSIGNMENT NUMBER	ADVANCES			COMMISSION DEDUCTED		NET PROCEEDS	SALES
	FREIGHT	DRAYAGE	DRAFTS	RATE	AMOUNT		
1200	$19.40	$ 4.00	$ ------	10%	$ 674.65	$ 6,048.45	$ 6,746.50
1201	7.25	3.50	1,000.00	10%	167.42	496.03	1,674.20
1204	10.10	2.00	500.00	8%	199.00	1,776.46	2,487.56
1205	16.70	2.50	------	5%	75.00	1,405.80	1,500.00
1206	7.56	3.00	750.00	10%	214.48	1,169.76	2,144.80
1207	18.80	6.50	2,000.00	5%	424.89	6,046.56	8,496.75
	$79.81	$21.50	$4,250.00	---	$1,755.44	$16,943.06	$23,049.81

Receipts during the month consisted entirely of payments by customers on account and totaled $21,475.75; while disbursements were made up of freight $102.90; drayage $12.00; drafts $2,750.00; net proceeds $16,943.06; salaries $575.00; rent $200.00; unexpired insurance $166.00; general expense $134.50.

On October 31, 1917, there were accounts payable of $125.40; consisting of freight bills $26.36, and general expense bills $99.04. Insurance that expired during the month amounted to $65.

From the foregoing information prepare a balance sheet at October 31, 1917, and a statement of profit and loss for the month ending that date.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

APRIL 2

Give petty cashier check for $87 to replenish petty cash fund upon presentation of receipts for disbursements chargeable as follows: $24 to Miscellaneous Selling Expenses; $11 to Delivery Expenses; $35 to Office Expenses; and $17 to General Expenses. Purchase 30 automobiles from Well-Built Auto Co. at $1,500 each, invoice No. 8621, dated March 30, terms 1/10, net 30 days.

APRIL 3

Pay commissions on automobile sales to John White, amounting to $3,550. Pay rent for March and April, $100. Pay for repair of auto truck which was damaged in a collision, $514 (charge Delivery Expense). Pay freight bill of $100 on accessories and supplies sale to Frank Rice on March 21 (Freight-Out).

APRIL 4

Receive a consignment of six automobiles from the Detroit Automobile Co., to be sold on a 20% commission basis. (This is to be known as consignment-inward No. 1. Should this transaction be recorded on the books of account?) Pay freight on above automobiles amounting to $250 which is chargeable against the consignment. Sold F. A. Norton of Bloomfield one automobile (from our own stock) at $2,000, terms C. O. D. Pay freight on the auto sold to F. A. Norton, $35, the agreement being to ship f.o.b. Bloomfield.

APRIL 5

Purchase safe for store, paying $200. Fred Miller takes accessories from stock which are to be charged at $210, the cost thereof.

APRIL 6

Cash sale of accessories $350. James Garage Co. send us the following account sales on consignment-outward No. 2:

ACCOUNT SALES WITH MILLER BROS.

Sales--10 automobiles at $2,200 each		$22,000.00
Deduct--Storage	$ 100.00	
Commission	2,000.00	2,100.00
Net Proceeds		$19,900.00

They send us a check for $9,900 and give us a 30-day note, bearing interest at 6% for the balance of the net proceeds on the account sales, amounting to $10,000.

APRIL 7

Pay storage charges of $60 on consignment-inward No. 1.

APRIL 9

W. F. Newton remits a check for $5,600 and a 30-day 6% note for $2,000 in full settlement of consignment-outward No. 1. An account sales for this consignment was received March 26. The note is signed by Lloyd Jones and indorsed by W. F. Newton. We pay on account invoice No. 8621 from the Well-Built Auto Co., by remitting a check for $39,600, the balance of $400 being a discount of 1% which they allow.

APRIL 10

Receive remittance on C. O. D. to F. A. Norton, $2,000. Cash sale of accessories $165.

APRIL 11

Receive a consignment of four automobiles from the Star Auto Co., to be sold on a 20% commission basis (consignment-inward No. 2).

APRIL 12

Sell the six automobiles of the Detroit Automobile Co. for $12,000 cash (consignment-inward No.1). Pay bill for supplies and stationery, amounting to $2,400, in connection with the installation of the new bookkeeping system March 1 (charge Office Expense). Pay bill of $4,800 for bill-board advertising for the two months of March and April per contract with Slade & Co.

APRIL 13

Pay our note of March 12, in favor of Well-Built Auto Co., with interest, giving a check for $10,100 and a new note for 30 days from April 12 at 6% for the balance.

APRIL 14

Send Detroit Automobile Co. the following account sales on consignment-inward No. 1:

ACCOUNT SALES WITH DETROIT AUTOMOBILE CO

SALES --6 automobiles at $2,000 each		$12,000.00
DEDUCT--Freight	$ 250.00	
Storage	60.00	
Commission	2,400.00	2,710.00
NET PROCEEDS		$9,290.00

Send them a check for the net proceeds. (Note that the commission of $2,400 represents an earning and journal entry must be made for same.) C. O. D. sale to John Winston of one automobile at $2,000 f.o.b. St. Louis, shipped sight draft, bill of lading attached. Pay freight on above automobile $50. (Is this freight chargeable to C. O. D. account or Auto Freight-Out?)

Solution to Assignment 1-10-2

TRIAL BALANCE--MILLER BROS.
MARCH 31, 19--

Warehouse and Office Equipment	$1,250.00	
Delivery Equipment	1,750.00	
Inventory of Merchandise, March 1	10,890.00	
Consignment Stock Outward	18,300.00	
Customers Ledger	40,912.00	
Notes Receivable	2,400.00	
Cash	56,066.27	
Petty Cash Fund	100.00	
Unexpired Insurance	60.00	
Rent Paid in Advance	300.00	
Interest Prepaid	42.00	
Creditors Ledger		$21,900.00
Notes Payable		20,000.00
Bank Loan		6,000.00
Notes Receivable Discounted		2,400.00
Fred Miller--Capital Account		15,000.00
August Miller--Capital Account		15,000.00
Auto Sales		38,312.00
Auto Return Sales	2,000.00	
Auto Rebates and Allowances	200.00	
Accessories and Supplies Sales		59,310.00
Accessories and Supplies Return Sales	1,710.00	
Profits on Consignments-Outward		1,600.00
Discount on Purchases		364.50
Interest Received		.77
Auto Purchases	6,000.00	
Auto Freight-In	500.00	
Accessories and Supplies Purchases	34,580.00	
Office Salaries and Expense	60.00	
General Expense	50.00	
Delivery Expenses	253.00	
Advertising	350.00	
Salesmen's Salaries and Commissions	90.00	
Miscellaneous Selling Expense	1,520.00	
Discount on Sales	504.00	
	$179,887.27	$179,887.27

Solution to Problem 7

-September 30, 1917-

(1)

Consignments-Outward Trading Account	$943.00	
To--Consignments-Outward		$943.00

To close out inventory of consignments on Sept. 1 which have been sold during month as follows:

NUMBER	COST	CHARGES	RETURNS	NET
696	$455.00	$8.00	$300.00	$163.00
699	780.00	-----	-------	780.00
	$1,235.00	$8.00	$300.00	$943.00

(2)

Consignments-Outward Trading Account	2,200.00	
Consignments-Outward	1,931.00	
To-Merchandise Purchases		4,131.00

To transfer cost of shipments during September:

NUMBER	CLOSED OUT	OPEN
801	$ 660.00	---------
802	1,540.00	---------
803	---------	$1,056.00
804	---------	875.00
	$2,200.00	$1,931.00

(3)

Consignments-Outward Trading Account	61.00	
Consignments-Outward	16.00	
To--Freight		77.00

To transfer cost of freight on Sept. shipments:

NUMBER	CLOSED OUT	OPEN
801	$15.00	-----
802	46.00	-----
804	-----	$16.00
	$61.00	$16.00

(4)

Receipts from Consignments-Outward	4,250.00	
To--Consignments-Outward Trading Account		3,450.00
Consignments-Outward		800.00

To transfer receipts on consignments outward:

NUMBER	CLOSED OUT	OPEN
696	$275.00	-------
699	821.00	-------
801	680.00	-------
802	1,674.00	-------
803	---------	$800.00
	$3,450.00	$800.00

(5)

Consignments-Outward Trading Account	$246.00	
To--Profit and Loss		$246.00
To transfer gross profit on consignments closed out as follows:		

NUMBER	AMOUNT
696	$112.00
699	41.00
801	5.00
802	88.00
	$246.00

It would be desirable, perhaps, to refer to the net figure as "Consignments-Outward less Advances from Consignees." The method of carrying the consignments-outward on the balance sheet is correct.

ANSWERS TO QUESTIONS

Answer to Question 22--

August 1, 1917

C D, CONSIGNEE
IN ACCOUNT WITH
A B SEED COMPANY

March 30, 1917:		
Received Consignment of 15,200 packages at 10¢		$1,520.00
DEDUCTIONS ALLOWED:		
March 30, 1917: Freight paid	$4.75	
August 1, 1917: 2,490 packages returned at 10¢	249.00	
Commission of 20% on sales of 12,710 packages at 10¢	254.20	
Total Deductions allowed		507.95
NET PROCEEDS		$1,012.05

Answer to Question 23--The effect of this practice is to take up profits unearned on consignments not closed out at the date the books are closed. Consignments should not be treated as sales even though they may all be closed within a fiscal period. The true profit on the transaction is lost sight of. Another effect on the accounts is to overstate accounts receivable. Until consignments are settled for they remain part of the merchandise inventory to be valued at cost, not selling price. Moreover, it is oftentimes desirable to indicate on a statement of profit and loss the profit from trading and from consignments separately.

Answer to Question 24--

Face of note	$1,500.00
ADD--Interest at 6% for 90 days	22.50
	$1,522.50
DEDUCT--Discount of 5% for 75 days	15.86
NET PROCEEDS	$1,506.64

ENTRIES ON BOOKS OF LYNN

(1)
-January 7, 1917-

Notes Receivable	$1,500.00	
To--E. G. Kemp		$1,500.00
To record 90-day note received on account, interest at 6%, dated January 7.		

(2)
-January 22, 1917-

Cash	1,506.64	
Prepaid Interest	15.86	
To--Notes Receivable Discounted		1,500.00
Interest Received		22.50
E. G. Kemp's note discounted. (Prepaid Interest account will be reduced at the end of an accounting period by the amount expiring during that period.)		

(3)
-April 6, 1917-

Notes Receivable Discounted	1,500.00	
To--Notes Receivable		1,500.00
E. G. Kemp pays his note due today.		

ENTRIES ON BOOKS OF KEMP

(1)
-January 7, 1917-

J. S. Lynn	1,500.00	
To--Notes Payable		1,500.00
Gave 90-day note on account, interest at 6%, dated January 7.		

(2)
-April 6, 1917-

Notes Payable	1,500.00	
Interest Accrued on Notes Payable	22.50	
To--Cash		1,522.50
Paid our note dated January 7, 1917, due today.		

CONSIGNMENTS-INWARD

Review I-9-7 to 10.

The records of the consignee should be so kept that any information concerning each consignment received may be easily available. They must also be accurate so that where numerous consignments are handled no item can be omitted in preparing accounts sales. But the most important feature is that the accounts having to do directly with the consignments (sales and deductible expenses) are AGENTS' accounts and are kept for the benefit of the PRINCIPAL or consignor. This income and expense should therefore be kept in separate accounts and not confused with sales of goods owned or expenses incurred in making sales of owned goods.

There are several ways of constructing the accounts of a business so that consignments-inward may be handled in conformity with the above principles. Ordinarily, it is unnecessary to enter the value of the consignments received. In many cases no notification of the value will be sent the consignee, the selling price, perhaps, depending on market quotations; moreover the goods received are not part of the consignee's assets nor is any legal liability present until the goods have been sold. The two methods following indicate primarily ways in which consignments-inward are handled on the books of commission merchants who deal in produce--vegetables, fruits, butter, eggs, etc., and who are del credere agents. The same methods may apply also to other businesses where similar conditions exist.

1. Where the number of consignments-inward is small, as is the case with Miller Brothers, two accounts may be opened: "Advances on Consignments-Inward" and "Earnings on Consignments-Inward." The method of operating these two accounts may be seen from the following:

ADVANCES ON CONSIGNMENTS-INWARD

DEBIT WITH

All charges paid by the consignee and deductible on the account sales, such as drafts, freight, drayage, storage, etc., at the same time crediting Cash or Accounts Payable.

Commission deducted by the consignee on the account sales as his profit, at the same time crediting Earnings on Consignments-Inward.

At the end of a monthly or fiscal period, commission taken by the consignee as the profit to which he is entitled on sales on consignments not closed out, at the same time crediting Earnings on Consignments-Inward.

Settlements made with consignor, being the net proceeds appearing on the account sales, at the same time crediting cash or the consignor's personal account.

CREDIT WITH

At the beginning of a period, an amount equal to the third debit per contra (made at the end of the previous period), at the same time debiting Earnings on Consignments-Inward. (This is a "reversing" entry.)

Sales of consignments, at the same time debiting Cash or Customers account.

The balance of the account, if more than one consignment remains open, may be made up of both (1) assets (advances on consignments of which no sales have been made or the sales of which so far do not exceed the advances thereon), and (2) liabilities (sales of consignments exceeding the advances). If such is the case, two balances should be carried down when the account is ruled, one a debit and the other a credit.

EARNINGS ON CONSIGNMENTS-INWARD

DEBIT WITH	CREDIT WITH
At the beginning of a period, an amount equal to the second credit per contra (made at the end of the previous period), at the same time crediting Advances on Consignments-Inward.	Commission deducted by the consignee on the account sales as his profit, at the same time debiting Advances on Consignments-Inward.
	At the end of a monthly or fiscal period, commission taken by the consignee as the profit to which he is entitled on sales of consignments not closed out, at the same time debiting Advances on Consignments-Inward.

The balance of the account is a credit, representing income from consignments-inward and will be closed out at the end of the period to Profit and Loss.

If a number of consignments-inward are on hand at the same time, it may be found desirable to install a subsidiary ledger called a "Consignments-Inward Ledger." A page is assigned to each consignment received, which page is removed when the consignment has been sold out and settled for. Advances on Consignments-Inward thus becomes a controlling account and special columns should be provided in the cash receipts book, cash disbursements book, sales book, and general journal. Under such conditions the debits and credits to the account as outlined above will remain the same except they will be made in totals and only at the end of each period.

Hence under the first method, the sales made and the expenses incurred on behalf of the consignor are made to offset each other in the same account.

2. In the second method, separate accounts are kept with each element appearing on the account sales: freight, cartage, drafts, other deductions, net proceeds, and sales. The expense accounts are debited through the cash disbursements book or purchases record, etc.; the Drafts account and the Net Proceeds account are debited through the cash disbursements book as the payments are made or liabilities incurred. Special columns may be provided in books of original entry if these items are numerous. A Sales of Consignments-Inward account should be credited periodically from the total of a column headed "Sales of Consignments-Inward" appearing in the sales book.

When a consignment is closed out under this method, Cash or the consignor's personal account will be credited and Net Proceeds account debited. But this entry does not show that a portion of the expense accounts, those pertaining to the consignment just closed, nor that a part of the Sales account has been settled for by the mere act of remitting net proceeds. Nor does it indicate in any way that a profit (commission) has been earned. Hence, at the time net proceeds are remitted, a journal entry should be made to write off that portion of the ledger accounts which have been settled for and to set up the earnings or commission retained by the consignee. The following entry is based on the illustration of account sales appearing in I-9-7 and is made on the books of O. B. Fox:

-April 4, 1917-

Sales	$46.00	
To--Freight		$ 3.45
Cartage		.80
Storage		1.20
Sales Discounts		.92
Commissions		3.22
Net Proceeds		36.41

To close out expenses and income from lot No. 87934, and to set up commission earned.

As under the first method, when the consignments received are numerous a subsidiary ledger may be kept. A page is allowed for each consignment which shows advances and sales thereon. But instead of having but one controlling account there will be several controlling accounts or several accounts making up the controlling figures. Thus, in the business of O. B. Fox there would be five accounts controlling the postings in his consignments-inward ledger: Sales, Freight, Cartage, Storage, and Net Proceeds, the sum of whose balances must equal the sum of the balances of the accounts with consignments not closed out. Take, for example, the nature of postings made to the Freight account:

FREIGHT ON CONSIGNMENTS-INWARD

DEBIT WITH	CREDIT WITH
Freight expense incurred on consignments-inward, at the same time crediting cash or accounts payable.	Postings from journal entries such as the one appearing above, the effect of which is to remove from the account freight charges which have been settled for.

The balance of the account will be a debit, representing the freight expense on account of consignments not yet closed out, and is therefore an asset to be carried forward to the next period.

On the balance sheet the total of debit balances of the subsidiary ledger accounts appears as an asset, "Advances on Consignments-Inward," among the current assets following "Merchandise Inventory"; the total of credit balances appears as a liability, "Due on Consignments Not Closed out," along with Accounts Payable.

To take up at the end of a period the adjustment of commissions earned on consignments not yet closed out, a journal entry should be made debiting Sales account and also the individual accounts with consignments in the subsidiary ledger (if one is kept) and crediting Commissions account. This entry will be reversed at the beginning of the following period.

A further elaboration of the second method is to introduce a journal especially adapted for the making of entries similar to the one above, called an Account Sales journal. Since the entries are all alike no explanation is required and each entry requires but one line as in a Sales journal. Special columns are provided for each element and postings are made in total to the ledger accounts affected.

REFERENCES:

Cole, pages 380-384
Esquerre, pages 186-207
Greendlinger and Schulze, pages 356-358

COMPLETE ACCOUNTING COURSE--PART I

Lecture 12

BILLS OF EXCHANGE; INVENTORIES

Problem 11

A certain trading corporation desires to prepare its financial statements as of September 30, 1917, but takes no inventory at that date. It has no perpetual inventory records, but the management states that the ratio of gross profit to net sales has remained substantially the same for many years, namely 35%, and that the ratio will remain the same for the year 1917. A summary of the merchandise account has been compiled, from which you are required to prepare a statement showing the estimated inventory on hand September 30, 1917.

SUMMARY OF MERCHANDISE ACCOUNT
SEPTEMBER 30, 1917

Inventory, January 1, 1917	$ 6,100.00	Sales	$44,500.00
Purchases	28,450.00	Discounts on Purchases	960.00
Freight-In	895.00		
Freight-Out	1,200.00		
Allowances on Sales	2,360.00		

MISCELLANEOUS QUESTIONS

Question 27--Outline several ways in which cash sales may be recorded in the books of Miller Brothers, bearing in mind the necessity of departmentalizing sales.

Question 28--
(a) How are C. O. D. sales handled in the books of account?
(b) Petty charge sales to occasional customers?

Question 29--What are selling expenses? General and administrative expenses? In your answer name the accounts with which you are familiar that would fall under each head.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

APRIL 16

Purchase accessories from New York Auto Supply Co. $21,200, invoice No. 7738, terms 1/10, net 30 days, f. o. b. shipping point. Pay freight of $360 on above bill.

APRIL 17

Ship James Garage Co. two automobiles, cost price $1,600 each, to be sold on a 5% commission basis (consignment-outward No. 3). Pay salesmen's traveling expenses, as per their reports, $300. Pay salary of auto truck driver, $100 for month of April. Sell accessories to Frank Rice on account $230. Pay salesmen's salaries $2,300, office help $400, and manager's salary $500, by pay-roll check. Pay for office supplies, $600. Receive notice from bank of collection on C. O. D. sale to John Winston April 14.

APRIL 18

Pay $3,000 on our note discounted by the bank and give them a demand note bearing interest at 6% for the balance of $3,000. (Note that here the note is not discounted but the interest is paid when the note becomes due.) Sell accessories amounting to $110, C. O. D., to John Lange.

APRIL 20

Note of $2,400 of Frank Rice, discounted by the bank March 21, is paid by the maker. The New York Auto Supply Co. accepts the return of accessories amounting to $3,600.

APRIL 21

Make an allowance of $10 on accessories sale to Frank Rice April 17. Draw a 30-day draft on Frank Rice for $100 which he accepts.

APRIL 23

Pay on invoice No. 7738 of New York Auto Supply Co. $10,000, consisting of cash $9,900, and discount of 1%, $100.

APRIL 24

Lloyd Jones prepays his 30-day note dated April 9 with interest accrued to date.

APRIL 25

Discount the note of James Garage Co. (dated April 6) at the bank at 6%. In recording the entry credit the difference between the face value of the note and the proceeds therefrom to Interest Received.

APRIL 26

Sell the four autos of the Star Auto Co. (consignment-inward No. 2) for $500 each to George Wilson on account. Send the following account sales, crediting their account in the creditors ledger for the net proceeds:

ACCOUNT SALES WITH STAR AUTO CO.

SALES		$2,000.00
DEDUCT--Storage	$ 20.00	
Commission	400.00	420.00
NET PROCEEDS		$1,580.00

The storage represents our storage charge and may be treated as a consignment earning.

APRIL 27

Receive a consignment of two automobiles from Midland Motor Co. to be sold on commission. (This is consignment-inward No. 3.) Pay freight on this consignment, $100, and advance Midland Motor Co. $1,000 cash thereon.

APRIL 28

Pay in cash salaries of partners for two months of March and April, Fred Miller receiving $800 and August Miller $1,000.

APRIL 30

Pay commissions to salesmen of $4,900. Reimburse petty cash fund by a check of $95, chargeable to General Expense. The bank has credited us with $50 interest on our average daily balance during March and April.

Adjustments of the following items should be made before closing the books:

1. Rent paid in advance.
2. Interest accrued on bank loan and on notes payable. (This can all be credited to Interest Accrued on Notes Payable account.)
3. Interest prepaid (transfer to Interest Paid).
4. Insurance expired to date is $10.
5. The inventory of stationery is $300.
6. Taxes accrued during the two months amount to $200.

Solution to Problem 8

EDWARDS & CO. AND PLANT & CO.
JOINT ACCOUNT
(Date)

PROCEEDS FROM SALES:		
First Draft	$3,200.00	
Second Draft	3,100.00	$6,300.00
DEDUCT--COST OF SALES:		
Merchandise Purchased	$5,000.00	
Freight	420.00	
Insurance	60.00	
Commission (2% on amount of invoice of merchandise)	100.00	5,580.00
NET PROFIT ON VENTURE		$ 720.00
Apportioned as follows:		
Plant & Co.--½	$360.00	
Edwards & Co.--½	360.00	
Total as above	$720.00	

EDWARDS & CO. ACCOUNT

DEBIT		CREDIT	
Discount on Note	$ 60.00	Cash Received	$1,200.00
Note Paid	3,000.00	Note Received	3,000.00
Balance--check sent	1,500.00	Proportion of Profits	360.00
	$4,560.00		$4,560.00

Journal entries necessary on books of Plant & Co.:

(1)

Cash	$1,200.00	
Note Receivable	3,000.00	
To--Edwards & Co.		$4,200.00

To record receipt of check for $1,200 and six months' note of $3,000 for purpose of joint venture.

(2)

Cash	2,940.00	
Edwards & Co.	60.00	
To--Note Receivable		3,000.00

To record discounting of note of Edwards & Co. which they gave us in lieu of cash.

(3)

Plant & Co. and Edwards & Co.--Joint Account	5,480.00	
To--Cash (or Expense Accounts)		5,480.00

To record payments made on account of joint venture as follows:

Smith & Greer, for merchandise	$5,000.00
Freight	420.00
Insurance	60.00
	$5,480.00

(4)

Plant & Co. and Edwards & Co.--Joint Account	100.00	
To--Commissions Earned (or Profit on Joint Venture)		100.00

To take credit for 2% commission on invoice of merchandise.

(5)

Cash	3,200.00	
To--Plant & Co. and Edwards & Co.--Joint Account		3,200.00

To record receipt of first draft for net proceeds.

(6)

Edwards & Co.	$3,000.00	
To--Cash		$3,000.00
Paid note of Edwards & Co.		

(7)

Cash	3,100.00	
To--Plant & Co. and Edwards & Co.--Joint Account		3,100.00
To record receipt of second draft.		

(8)

Plant & Co. and Edwards & Co.--Joint Account	720.00	
To--Edwards & Co.		360.00
Profit on Joint Venture		360.00
To close out joint account and distribute the profits thereof as per agreement.		

(9)

Edwards & Co.	1,500.00	
To--Cash		1,500.00
Sent Edwards & Co. check to close their account.		

<u>Solution to Problem 9</u>

ADJUSTING ENTRIES

(1)

Purchases--Silks	$2,145.00	
Rent	150.00	
Unexpired Insurance	220.00	
To--Accounts Payable		$2,515.00
To set up accounts payable not yet recorded.		

(2)

Taxes	200.00	
To--Taxes Accrued		200.00
To set up taxes accruing during October.		

(3)

Interest Paid	140.00	
To--Interest Accrued on Notes Payable		140.00
To take up interest accrued and not recorded on October 31.		

(4)

Insurance Expired	135.00	
To--Insurance Unexpired		135.00
To write off insurance expired.		

CLOSING ENTRIES

(5)

Silks--Trading Account	$18,140.00	
Linens--Trading Account	22,900.00	
To--Inventory--Silks		$18,140.00
Inventory--Linens		22,900.00
To close out inventories on November 1, 1916.		

(6)

Inventory--Silks	19,475.00	
Inventory--Linens	8,460.00	
To--Silks--Trading Account		19,475.00
Linens--Trading Account		8,460.00
To set up inventories on October 31, 1917, as per total of inventory sheets.		

(7)

Silks--Trading Account	64,078.00	
To--Purchases--Silks		59,310.00
Freight-In--Silks		1,798.00
Allowances and Returns--Silks		2,970.00
To transfer accounts.		

(8)

Linens--Trading Account	52,612.00	
To--Purchases--Linens		44,462.00
Freight-Out--Linens		1,520.00
Allowances and Returns--Linens		2,515.00
Discounts on Sales--Linens		4,115.00
To transfer accounts.		

(9)

Sales--Silks	82,476.00	
Sales--Linens	85,144.00	
To--Silks--Trading Account		82,476.00
Linens--Trading Account		85,144.00
To transfer sales accounts to trading.		

(10)

Silks--Trading Account	19,733.00	
Linens--Trading Account	18,092.00	
To--Profit and Loss		37,825.00
To transfer gross profit from trading.		

(11)

Profit and Loss	21,445.00	
To--Rent		1,800.00
Taxes		2,400.00
Salaries		11,675.00
Insurance Expired		1,315.00
Heating and Lighting		3,540.00
Interest Paid		715.00
To close out expense accounts.		

(12)

Profit and Loss	$16,380.00	
To--Partners' Drawing Accounts (in detail)		$16,380.00
To close out net profits for year.		

ANSWERS TO QUESTIONS

Answer to Question 25--

-December 31, 1917-

(1)

Membership Dues Unearned	$7,172.50	
To--Membership Dues Earned		$7,172.50
To close out deferred credit at beginning of period (January 1, 1917).		

(2)

Membership Dues Earned	7,600.00	
To--Membership Dues Unearned		7,600.00
To set up deferred credit to income at December 31, 1917, on account of prepaid membership dues as follows:		

Dues billed April 1, 1917--¼	$1,525.00
Dues billed July 1, 1917--½	1,275.00
Dues billed October 1, 1917--¾	4,800.00
Total as above	$7,600.00

The Membership Dues Earned account will now stand with a net credit of $23,372.50, which represents the income from dues applicable to the year 1917.

Answer to Question 26--

(a) April 6, 1917, counting the date of issue and omitting the due date or vice versa.

(b) April 7, 1917.

(c) The practice varies as between banks. If the 360-day year is used more interest will be collected than from the use of the 365-day year. Where the interest runs for a month or number of months, the ratio applying is the number of months to twelve. For instance, under the Illinois statute in computing the legal rate of interest on notes and bills which run "for any number of days less than a month, a day shall be considered a thirtieth part of a month, and interest or discount shall be computed for such fractional parts of a month upon the ratio which such number of days shall bear to thirty."

BILLS OF EXCHANGE

DEFINITION--"A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money, to order or to bearer." (Uniform Negotiable Instruments Act.) There are FOREIGN and INLAND bills of exchange, the most common illustration of the latter class being the ordinary commercial draft. A CHECK is also "a bill of exchange drawn on a bank, payable on demand."

PARTIES--There are four parties concerned in a bill of exchange: the DRAWER or MAKER, the DRAWEE, the ACCEPTOR, and the PAYEE. The drawer and payee are often the same party, while the drawee and acceptor are usually the same party. An acceptor other than the payee is an ACCOMMODATION ACCEPTOR.

ACCOUNTING FOR DRAFTS--Checks are treated as cash. Drafts are handled in various ways, depending on whether they are sight or time drafts, and if sight drafts, whether banks are willing to accept them as cash.

1. SIGHT DRAFTS--Ordinary sight drafts are handled as cash by the payee, while of course the drawee pays cash as soon as he is notified by the bank of the draft. "Collection" drafts and sometimes other sight drafts may not be accepted as cash by banks. If such is the case, the bank acts as a collection agent and a memorandum only of the fact is kept by the payee. When the bank sends notice that payment has been received, cash is debited and the account of the drawee credited, any expenses of collection being charged to a "Collection Expense" or similar account. If the drawer is not also the payee, no cash will be received by the former and on his records he will debit the account of the payee:

-June 6, 1917-		
Payee	$1,000.00	
To--Drawee		$1,000.00
To record the payment by the drawee of our draft dated June 1, 1917, in favor of the payee.		

2. TIME DRAFTS--Time drafts must first be ACCEPTED, that is, the drawee must agree to pay and must signify his intention to do so by writing the acceptance on the face of the draft, and thereby becoming the ACCEPTOR. Or the paper must be accepted by a party other than the drawee, in which case such party is called an accommodation acceptor. No entries are made on the books of any of the parties until acceptance is made, but as soon as a time draft is accepted it should be treated as a note receivable by the payee and as a note payable by the drawee, since the instrument, when accepted, is in effect a two-party agreement. The accommodation acceptor treats the draft as a contingent liability. On the books of both drawee and payee, the manner of handling "acceptances" is precisely the same as the manner of handling promissory notes. If the drawer is not also the payee he may follow the same treatment as suggested in the discussion of paid sight drafts, i.e., credit the drawee's account and debit the payee's account when he is notified of the acceptance, as illustrated in the preceding paragraph.

Acceptances may be discounted and treated as discounted promissory notes on the books of the payee.

Ordinarily it is unnecessary to distinguish on the books or on financial statements between "notes" and "bills" receivable or payable. The term "notes receivable" or "notes payable" generally covers both.

INVENTORIES

In the ordinary trading business three factors enter into the gross profit which is arrived at as follows:

SALES		$---------
DEDUCT--Cost of Sales made up of Inventory at beginning of period	$---------	
Add--Purchases	---------	
	$---------	
Deduct--Inventory at end of period	---------	---------
Balance--GROSS PROFIT		$---------

Merchandise when received is charged at cost and when sold is credited at selling price. Consequently the first factor, sales, and the second factor, purchases, can be readily obtained from the books. To obtain the third factor, inventory, it is necessary (1) to take a physical inventory of the stock on hand, or (2) to keep a perpetual inventory.

Taking a physical inventory refers to the actual listing of the stock on hand at a certain date so as to show quantity, unit price, and amount. In taking inventory the following points should be given attention.

1. Physical inventories are taken when the stock is low, the date usually marking the close of a season.

2. Inventories are usually taken by persons employed in the department under the direction of the head of the department. Occasionally outside parties are called in either to "take" the inventory or to check same as soon as taken by the employees.

3. Strict instructions should be given to the inventory-takers as to the method to be followed and the precautions to be observed. Written instructions are preferable.

4. The inventory sheets when handed out should be numbered so as to insure the return of all sheets.

5. Wherever possible, it is desirable to issue the sheets in advance and to list the description of the goods, location, etc. Usually provision is made for designating damaged, shop-worn, and obsolete goods. On the day as of which inventory is taken, the data previously recorded would be checked and the quantity and price inserted. Sometimes the pricing is done in the office.

6. The extensions, footings, and recapitulations should be performed in the office and checked by some person other than the one making the calculations in the first place.

7. Each inventory sheet should bear the signatures of those taking the inventory (caller and lister) so that responsibility for errors can be definitely placed.

8. In order to avoid confusion with new goods being received and goods being sold, it is important that the inventory be taken in the shortest possible time.

9. Goods sold after the close of the fiscal period, but delivered before inventory-taking, should be included as inventory at cost.

10. Consignments-inward still on hand should be separated from the inventory of purchased goods. Such goods will be listed on separate sheets and must be excluded from the inventory totals.

11. The invoices for all goods taken into stock should be entered on the general books before closing. The inventory which is credited to the Trading account should include only merchandise on hand, bills for which have been charged to Purchases account. Goods in transit will be taken up by the following entry:

Merchandise in Transit	$---------	
To Accounts Payable or Unaudited Invoices		$---------
To take up goods in transit at ----------		

This entry will be reversed at the beginning of the next fiscal period.

12. Prices are based on the rule of "cost or market, whichever is the lower at the inventory date." In determining cost it is proper to add freight-in, cartage-inward, and import duties. Trade discounts, quantity discounts, rebates, and other allowances should be deducted.

PERPETUAL INVENTORIES--The object of a perpetual or "going" inventory is to show the amount of merchandise on hand at any date. A perpetual inventory bears the same relation to merchandise that a cash record bears to cash. Receipts and issues may be listed as to (1) quantities only, (2) prices only, or (3) both. The price basis is generally cost, although in some cases selling price is used, the all-important point being that both receipts and issues are priced on the same basis. Physical inventories are taken periodically to check the accuracy of the perpetual inventory. The expense of keeping records of this kind however, may be far in excess of the benefits derived and they are not as common in trading concerns as in manufacturing enterprises, where they are essential for cost data.

The advantages of a perpetual inventory are:

1. To enable monthly profits to be ascertained.
2. To furnish the purchasing department with the data necessary to keep stocks on hand between a minimum and a maximum limit.
3. To keep a check on physical inventories with the object of ascertaining losses from theft, shrinkage, shortages, etc.

The perpetual inventory controlling account is usually supported by a stock ledger containing a card or sheet for each class of merchandise. The charges are entered from the creditors' invoices and the credits from the duplicate sales invoices, individually or in summary totals. The stock ledger accounts are adjusted to the physical inventory at the close of each fiscal period.

Perpetual inventories will be referred to again in connection with the accounts of a manufacturing business.

ESTIMATED INVENTORIES--If perpetual inventories cannot be had, it is feasible in some cases to approximate the amount of the inventory with substantial accuracy. The most common method is illustrated below and is referred to as the "gross profit" method.

-A-

NET SALES (actual)	$20,000.00
DEDUCT--Gross Profit (based on estimated percentage of net sales, say 40%)	8,000.00
BALANCE--ESTIMATED COST OF SALES	$12,000.00

-B-

INVENTORY at beginning of period	$ 5,000.00
ADD--Purchases (actual)	16,000.00
	$21,000.00
DEDUCT--Estimated Cost of Sales (as above)	12,000.00
Balance--ESTIMATED INVENTORY at close of period	$ 9,000.00

The estimated inventory at the close of the period is verified by taking a physical inventory.

The foregoing method may be used to advantage where the ratio of gross profit to sales varies but little from month to month. Where the ratio fluctuates, the result is apt to be erroneous.

REFERENCES:

Bays (American Commercial Law Series, Vol. II)
Cole, pages 118-120
Dickinson, pages 93-99
Esquerre, pages 165-172
Gilman, pages 167-178

COMPLETE ACCOUNTING COURSE--PART I

Lecture 13

POINTS INVOLVED IN CLOSING BOOKS

Problem 12

The trial balance following is from the ledger of John Hand, real estate and insurance agent:

TRIAL BALANCE, DECEMBER 31, 1917

John Hand--Capital Account, January 1, 1917		$24,500.00
John Hand--Drawing Account	$ 2,100.00	
Apartment House	60,000.00	
North Park Subdivision	21,000.00	
Personal Ledger		1,800.00
Cash	500.00	
Mortgage Payable		30,000.00
Aetna Insurance Company		150.00
Continental Insurance Company		50.00
Oriental Casualty Company		200.00
North Park Subdivision Sales		19,200.00
Apartment House Rent		8,000.00
Apartment House Expense	1,900.00	
Commission on Rentals		800.00
Commission on Real Estate Sales		4,600.00
Commission on Insurance		1,200.00
Office Expenses	1,100.00	
Office Rent	600.00	
Advertising	400.00	
Interest on Mortgage	900.00	
Commission Paid Sub-Agents on Subdivision Sales	2,000.00	
	$90,500.00	$90,500.00

Hand owns the apartment house on which the $30,000 mortgage applies. All rent thereon is credited to Apartment House Rent account, and all expenses are charged to Apartment House Expense account. Rent accrued and not paid December 31, 1917, amounts to $400 and is collectible. There is also $900 interest accrued and due on the mortgage but not paid. Neither of these items appears on the books as yet.

Hand also owns the North Park Subdivision. The original cost and the cost of all subsequent improvements have been charged to North Park Subdivision account. There are 21 lots of equal value; 11 of these have been sold and the sales price credited to North Park Subdivision Sales account.

The amounts due insurance companies are on premiums collected but not yet remitted. The entry in the cash book on the collection of a premium is as follows:

Cash	$60.00	
To--Aetna Insurance Company		$48.00
Commission on Insurance		12.00

The personal ledger is a card ledger containing both debtors' and creditors' accounts. The debtors amount to $600 and the creditors to $2,400.

You are required to submit:

(a) Balance sheet as of December 31, 1917.
(b) Statement of profit and loss for year ending December 31, 1917.
(c) Journal entries to close the ledger at December 31, 1917.

MISCELLANEOUS QUESTIONS

Question 30--How would you proceed to locate errors in a trial balance? Outline the various tests you would make.

Question 31--The firm of A and B has for several years valued its merchandise inventory on the basis of sales prices. If the stock of merchandise at the close of each of these periods was approximately of the same kind and value, what effect would this procedure have on the successive balance sheets prepared? On the successive statements of profit and loss?

Question 32--The firm of C and D on June 30, 1917, in taking its annual inventory discovered that whereas the merchandise on hand cost $50,000, not more than $30,000 could be realized therefrom at that date on account of a sudden fall in the market price. Purchases during the year amounted to $150,000, the value (at cost) of the opening inventory was $40,000, and the sales for the period were $155,000. The firm figures that a gross profit of $15,000 has been made on the goods sold, but this figure will be turned into a gross loss of $5,000 if in the cost of sales statement the closing inventory is taken at the realizable value of $30,000.

What should be done under the circumstances?

WORK TO BE DONE IN THE PRACTICE SET

Having made the adjusting entries called for in I-12-3, post the books of original entry and submit a trial balance.

Solution to Problem 10

A. R. MILES & CO.
BALANCE SHEET, OCTOBER 31, 1917

ASSETS			LIABILITIES		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash	$14,759.69		Accounts Payable	$ $125.40	
Accounts Receivable	10,209.48	$24,969.17	Due on Consignment not closed out	1,490.68	$1,616.08
PREPAID EXPENSE:					
Insurance		586.00			
CAPITAL ASSETS:			CAPITAL ACCOUNT:		
Furniture and Fixtures		2,000.00	Balance, Oct. 1, 1917	$25,442.61	
			Profits for October	496.48	25,939.09
		$27,555.17			$27,555.17

A. R. MILES & CO.
STATEMENT OF PROFIT AND LOSS
MONTH ENDING OCTOBER 31, 1917

Commissions Earned		$1,570.02
Operating Expenses:		
Salaries	$575.00	
Rent	200.00	
Insurance	65.00	
General Expense	233.54	1,073.54
Net Profit (as above)		$ 496.48

POINTS INVOLVED IN CLOSING BOOKS

METHOD--Four methods of closing the books of a trading concern have already been illustrated:

1. Where a Merchandise account and Profit and Loss account are kept (there being no separate inventory account), the inventory at the end of the period is credited direct to the Merchandise account, and the balance, representing gross profit, is carried to the Profit and Loss account together with all other nominal accounts; the net profit is then carried to the respective drawing accounts; and the excess of the net profits over the drawings is carried to the capital accounts. (See I-5-5.)

2. If the merchandise inventory is carried in a separate ledger account, it is necessary to transfer the opening inventory from the Inventory account to the Merchandise account. The closing inventory when taken upon the books will be charged to the Inventory account at the same time that the credit is made to the Merchandise account. (See I-6-4.)

3. Where the Merchandise account is subdivided into its elements of Inventory, Purchases, Sales, etc., one method of procedure is to open up a Cost of Sales account, into which the opening inventory, closing inventory, and purchases are carried. The balance is the cost of merchandise sold, which may be carried to (a) Sales account, or (b) Trading account, or (c) to the Profit and Loss account. (See I-10-5.) Sales would be transferred to Trading account in case (b) and to Profit and Loss account in case (c).

4. Where the Merchandise account is subdivided into its elements of Inventory, Purchases, Sales, etc., a common method of procedure is to open up a Trading account into which all these merchandise accounts are transferred. The balance will be gross profit from trading to be carried to Profit and Loss, similar to the balance of Merchandise account in method 1. (See I-12-6.)

A fifth method is sometimes used: all nominal accounts are closed by a single journal entry into the proprietor's drawing account, no Trading account or Profit and Loss account appearing on the ledger. In this instance, the proprietor would depend, for an analysis of his profits during any given period or for a comparison between profits of successive periods, not on the financial records themselves but on the financial statements prepared at the end of each period. There is also no distinction drawn between items making up cost of sales and items which compose operating expenses, etc. The method is disfavored by accountants generally.

CLEARING ACCOUNTS--The Trading account, Cost of Sales account, and Profit and Loss account are often called CLEARING ACCOUNTS, inasmuch as they are opened and closed only at the end of each accounting period and serve to clear various elements of profits from particular nominal accounts to others.

CLASSIFICATION OF ENTRIES--Since new types of entries have arisen in connection with closing the books, it is desirable to outline them here more fully.

1. ENTRIES FOR TRANSACTIONS. These are the entries made during the period concerning the relations of the business to outsiders: purchases, sales, payments on accounts, expenses, etc.

2. ADJUSTING ENTRIES. A distinction should be made between adjusting and closing entries. The former precede and are made for the purpose of restating certain assets and liabilities for balance sheet purposes.

3. CLOSING ENTRIES. Closing entries are the entries necessary at the end of an accounting period for the purpose of transferring the nominal accounts.

4. REVERSING ENTRIES. The term "reversing entries" refers particularly to entries that may be made at the beginning of a fiscal period which reverse certain entries made at the end of the period just closed. Thus, Inventory of Miscellaneous Supplies account may be written back to the expense accounts, the inventories of which it represents; likewise Interest Accrued on Notes Receivable in the second method outlined (see I-10-8 to 9); sometimes Merchandise Inventory is closed back into Merchandise account.

5. CORRECTING ENTRIES. When it is necessary to alter accounts because of errors in recording transactions referring thereto, the entries required are termed "correcting" entries. The last four classes of entries record no transactions, their purpose being to put the accounts on a proper accounting basis.

"CLOSING THE BOOKS"--This term may refer to one of three things:

1. Closing the nominal accounts at the end of an accounting period.
2. Closing a set of accounts to be transferred to another ledger.
3. Closing out the accounts of a liquidated or defunct business or of a business whose accounts are transferred to another business.

REASON FOR CLOSING THE BOOKS AT THE END OF A FISCAL PERIOD

Nominal accounts have been referred to as subdivisions of the proprietorship accounts. They are kept during a fiscal period for the purpose of disclosing the sources and details of the profits and expenses during that period. They serve also the purpose of showing the increases or decreases of proprietorship; but this increase may be indicated as well by single entry where no nominal accounts are kept.

WHAT REMAINS ON BOOKS AFTER CLOSING--Only real accounts, i.e., balance sheet accounts, remain on the books after closing, the valuation of which is arrived at as follows:

1. Capital assets at their cost less accrued depreciation (the subject of depreciation will be taken up later).
2. Current assets at not more than their realizable value, (i.e., realizable value to the "going concern").
3. Prepaid expenses benefiting future periods, at cost.
4. Liabilities on the basis of items ACCRUED (no matter whether due or not).
5. The proprietor's account represents the difference between the assets and liabilities thus arrived at.

The purpose of this brief summary of balance sheet accounts is to remind the student that the term VALUE in Accounting as applied to real accounts has a meaning entirely distinct from the same term as used in other sciences. The value of a business on a liquidating basis would differ from the value of the same business as a going concern; while both may differ from the value (net worth or proprietor's account) appearing on the firm's books.

REFERENCES:

Cole, Chapter V
Gilman, Chapter IV

COMPLETE ACCOUNTING COURSE--PART I

Lecture 14

GENERAL REVIEW QUESTIONS

(For oral quiz)

Question 33--Distinguish between single and double entry.

Question 34--Give the entries necessary to change a set of books from single entry to double entry.

Question 35--How would you determine the profit or loss for a given period, (a) from single entry books; (b) from double entry books?

Question 36--Distinguish between capital and revenue expenditures and give illustrations of each. Why is so much stress laid on the correct classification of expenditures?

Question 37--What are the objections to the "Merchandise" account? In your opinion, what is the best method of recording the information usually contained in the Merchandise account?

Question 38--What is a petty cash fund? You are instructed to set aside $100 as a petty cash fund; give the entries to be made.

Question 39--Without using amounts, submit a specimen balance sheet such as you would prepare for a partnership engaged in an industrial line of business.

Question 40--Distinguish between trade and cash discounts. Show several methods of entering them on the books.

Question 41--Distinguish between interest, cash discount, and bank discount.

Question 42--Give the entries you would make in case a note which had been given you by a customer is dishonored.

Question 43--What are the advantages of having Purchases and Sales accounts in subsidiary ledgers, and what is the best method of checking the accuracy of the postings to these accounts?

Question 44--What is the best method of handling C. O. D. shipments where the consignee does not have a regular ledger account?

Question 45--Define a note. Give the parties to a note.

Question 46--Define a bill of exchange. Give the parties to such an instrument.

Question 47--Distinguish between the following instruments:

(a) Note
(b) Bill of Exchange
(c) Sight Draft
(d) Time Draft
(e) Bank Draft
(f) Check

Question 48--Give the required entries to be made when:

(a) Our note is given to a creditor in payment of what we owe.
(b) A note is received from a customer in payment of his account.
(c) When (b) is dishonored at maturity.

Question 49--Give the entries required when we discount:

(a) A note which we have received from a customer.
(b) Our own note.

Question 50--Give the required entries:

(a) When you accept a time draft drawn upon you by a creditor.
(b) When you draw a time draft on a customer, which he accepts.
(c) When you draw a sight draft on a customer.

Question 51--What is a controlling account? Give the items which would appear in the customers' and creditors' controlling accounts, respectively.

Question 52--Draw up a partnership agreement, incorporating such features as you deem desirable for a proper guide to the partners.

Question 53--Where articles of partnership do not state the proportion of profits each partner is to receive, on what basis are they divided?

Question 54--If the profits are to be divided on the basis of amount of capital and length of time invested, how would you ascertain what proportion of the profits each partner is entitled to?

Question 55--What is the distinguishing feature between a consignment and a sale? Give several reasons for making consignments.

Question 56--What are capital assets; current assets; floating assets; liquid assets; quick assets; fixed assets? Give examples of each. What difference, if any, is there between them?

What are capital liabilities; fixed liabilities; current liabilities; floating liabilities ? Give examples and state what difference, if any, there is between them.

Question 57--On what basis should an inventory be valued? Give your reasons.

WORK TO BE DONE IN THE PRACTICE SET

The merchandise inventory at the beginning of the period (March 1) was divided as between automobiles $8,000, and accessories and supplies $2,890. On April 30, the inventory was composed of automobiles $30,000 and accessories and supplies $5,890.

Prepare and submit a balance sheet and statement of profits and income (report form), covering the two months ending April 30, and close the books.

Solution to Assignment I-13-2

SCHEDULE OF CUSTOMERS LEDGER ACCOUNTS

C. O. D.	$ 110.00
E. T. Adams	14,000.00
Barnhart and Co.	12,312.00
Frank Rice	7,120.00
George Wilson	2,000.00
Total per Customers Ledger Accounts in General Ledger	$35,542.00

SCHEDULE OF CREDITORS LEDGER ACCOUNTS

New York Auto Supply Co.	$29,500.00
Well-Built Auto Co.	5,000.00
Star Auto Co.	1,580.00
Total per Creditors Ledger Accounts in General Ledger	$36,080.00

MILLER BROS.--TRIAL BALANCE, APRIL 30, 19--

Warehouse and Office Fixtures	$ 1,450.00	
Delivery Equipment	1,750.00	
Inventory of Merchandise	10,890.00	
Consignment Stock Outward	3,200.00	
Miscellaneous Supplies	300.00	
Advances on Consignments-Inward	1,100.00	
Customers Ledger	35,542.00	
Notes Receivable	10,100.00	
Cash	3,676.84	
Petty Cash Fund	100.00	
Unexpired Insurance	50.00	
Rent Paid in Advance	200.00	
Creditors Ledger		$36,080.00
Notes Payable		10,000.00
Bank Loan		3,000.00
Notes Receivable Discounted		10,000.00
Taxes Accrued		200.00
Interest Accrued on Notes Payable		36.00
Fred Miller--Capital Account		15,000.00
Aug. Miller--Capital Account		15,000.00
Fred Miller--Drawing Account	210.00	
Auto Sales		42,312.00
Auto Return Sales	2,000.00	
Auto Rebates and Allowances on Sales	200.00	
Auto Freight-Out	85.00	
Accessories and Supplies Sales		60,165.00
Accessories and Supplies Return Sales	1,710.00	
Accessories and Supplies Rebates and Allowances on Sales	10.00	
Accessories and Supplies Freight-Out	100.00	
Profits on Consignments-Outward		3,200.00
Earnings on Consignments-Inward		2,820.00
Discount on Purchases		864.50
Interest Received		87.34
Auto Purchases	47,800.00	
Auto Freight-In	500.00	
Accessories and Supplies Purchases	55,570.00	
Accessories and Supplies Freight-In	360.00	
Accessories and Supplies Return Purchases		3,600.00
Rent	200.00	
Taxes	200.00	
Insurance Expense	10.00	
Office Salaries and Expenses	5,495.00	
General Expense	162.00	
Delivery Expenses	878.00	
Advertising	5,150.00	
Salesmen's Salaries and Commissions	10,840.00	
Salesmen's Traveling Expenses	300.00	
Miscellaneous Selling Expenses	1,544.00	
Interest Paid	178.00	
Discount on Sales	504.00	
	$202,364.84	$202,364.84

Solution to Problem 11

X Z COMPANY

METHOD OF ESTIMATING INVENTORIES AT SEPTEMBER 30, 1917

GROSS SALES		$44,500.00
LESS--Freight-Out	$1,200.00	
Allowances	2,360.00	3,560.00
NET SALES		$40,940.00
DEDUCT--Estimated Gross Profit of 35% of Net Sales		14,329.00
Balance--ESTIMATED COST OF SALES		$26,611.00
Inventory at January 1, 1917		$ 6,100.00
ADD--Purchases	$28,450.00	
Freight-In	895.00	
	$29,345.00	
Less--Discount on Purchases	960.00	28,385.00
Total Merchandise Cost		$34,485.00
DEDUCT--Estimated Cost of Sales		26,611.00
Balance--ESTIMATED INVENTORY at September 30, 1917		$ 7,874.00

ANSWERS TO QUESTIONS

Answer to Question 27--

(a) Enter the cash in the cash receipts book, at the same time crediting the departmental sales accounts in the general ledger.

(b) Enter the cash in the cash receipts books, which is to be posted to Cash Sales account in the customers ledger. At the same time make an entry in the sales book debiting "Cash Sales" account in the customers ledger, crediting the proper department as in the case of a "charge" sale.

(c) Same as No. 2, except that instead of carrying a customers ledger account for Cash Sales, the items of cash sales in the cash book and cash sales in the sales book are merely checked against each other.

Separate columns may be provided in the cash receipts book and sales book for cash sales, the totals of which are posted to the credit and debit, respectively, of a Cash Sales account in the general ledger.

Answer to Question 28--

(a-1) C. O. D. sales may be handled as cash sales--only a memorandum record being kept of C. O. D.'s as they are forwarded to the customer and no credit being taken for the sale until the cash has been received.

(a-2) Charge C. O. D. sales to a C. O. D. account in the customers ledger which is then credited as the cash is received.

(a-3) Charge directly to the customer's account.

(b) Rather than open up a separate account for such customers, a single ledger page in the customers ledger may be headed "Sundry Customers" and such items posted thereto. When one of these customers pays his account, the credit should be entered in the space directly opposite the charge.

Answer to Question 29--Selling expenses are those expenses of a business which are incurred in selling the product manufactured or purchased, and usually are represented by:

Salesmen's Salaries and Commissions
Traveling Expenses of Salesmen
Samples Distributed
Advertising
Salaries of Sales Management
Salaries and Expenses of Credit Department
Sales Office Expenses

Freight allowances in the nature of "special inducements" to secure customers may be treated as a selling expense; but if such item represents a regular yearly allowance and is not the result of a special advertising campaign, etc., it is treated as a deduction from gross sales. Trade discounts are always deductions from gross sales.

General and administrative expenses are those expenses of a business incurred in its general administration, such as:

Officers' Salaries
Office Salaries
Office Expenses--Stationery and Supplies, etc.
Telephone and Telegraph
Legal Expenses
Traveling Expenses of Officers
Heat and Light--Office
Repairs to Office Building
Repairs to Furniture and Fixtures
Taxes
Insurance

COMPLETE ACCOUNTING COURSE--PART I

Lecture 15

ANSWERS TO GENERAL REVIEW QUESTIONS

Solution to Problem 12

JOHN HAND
BALANCE SHEET, DECEMBER 31, 1917

ASSETS			CAPITAL AND LIABILITIES		
CAPITAL ASSETS:			CAPITAL ACCOUNT:		
Apartment House		$60,000.00	Balance, January 1, 1917		$24,500.00
			Profit for year as below		15,400.00
CURRENT ASSETS:					
North Park Subdivision	$10,000.00				$39,900.00
Accounts Receivable	600.00		Drawings		2,100.00
Rents Uncollected	400.00		Balance, December 31, 1917		$37,800.00
Cash	500.00	11,500.00			
			MORTGAGE		30,000.00
			CURRENT LIABILITIES:		
			Accounts Payable	$2,400.00	
			Due Insurance Cos.	400.00	
			Interest Accrued	900.00	3,700.00
		$71,500.00			$71,500.00

JOHN HAND
STATEMENT OF INCOME AND EXPENDITURES
YEAR ENDING DECEMBER 31, 1917

INCOME:			
Apartment House Rent		$ 8,400.00	
Deduct--Apartment House Expense		1,900.00	$ 6,500.00
Sales of North Park Subdivision Lots		$19,200.00	
Deduct--Cost of Lots Sold	$11,000.00		
Commissions Paid Subagents	2,000.00	13,000.00	6,200.00
Commission on Real Estate Sales			4,600.00
Commission on Insurance			1,200.00
Commission on Rentals			800.00
TOTAL INCOME			$19,300.00
EXPENDITURES:			
Office Expenses		$1,100.00	
Office Rent		600.00	
Advertising		400.00	2,100.00
NET INCOME before deducting Interest			$17,200.00
DEDUCT--Interest on Mortgage			1,800.00
SURPLUS NET INCOME (as above)			$15,400.00

JOURNAL ENTRIES TO CLOSE LEDGER, DECEMBER 31, 1917

(1)		
Rent Unpaid	$ 400.00	
To--Apartment House Rent		$ 400.00
To record rent due and unpaid.		
(2)		
Interest on Mortgage	900.00	
To--Interest Accrued on Mortgage		900.00
To take up interest accrued and unpaid.		
(3)		
Apartment House Rent	1,900.00	
To--Apartment House Expense		1,900.00
To transfer apartment house expense to rent account (the latter account now shows the income from the apartment house.)		
(4)		
North Park Subdivision Sales	13,000.00	
To--North Park Subdivision		11,000.00
Commissions Paid Subagents		2,000.00
To transfer cost of subdivision sales.		

(5)

Apartment House Rent	$ 6,500.00	
North Park Subdivision Sales	6,200.00	
Commission on Rentals	800.00	
Commission on Real Estate Sales	4,600.00	
Commission on Insurance	1,200.00	
To--Profit and Loss		$19,300.00
To transfer income to Profit and Loss.		

(6)

Profit and Loss	3,900.00	
To--Office Expenses		1,100.00
Office Rent		600.00
Advertising		400.00
Interest on Mortgage		1,800.00
To transfer expense account to Profit and Loss.		

(7)

Profit and Loss	15,400.00	
To--John Hand--Drawing Account		15,400.00
To close out net income for year.		

(8)

John Hand--Drawing Account	13,300.00	
To--John Hand--Capital Account		13,300.00
To close out balance of Drawing account.		

ANSWERS TO QUESTIONS

Answer to Question 30--

1. Check the footings of the trial balance.
2. Check transfer of balances from ledger to trial balance.
3. If the diffence is "1" in any column it is probably an error in footing.
4. Ascertain whether any account appearing in the trial balance has been closed out during the month.
5. Ascertain whether an item equal to one-half the discrepancy has been posted to the wrong side of the ledger.
6. Look for an error in posting caused by a transposition or transplacement of figures (divide the difference by 9 or a multiple thereof).
7. Check footings of ledger accounts and books of original entry.
8. These tests having been made, it is likely that the error arises from an item not posted or posted incorrectly. If it seems necessary to review the postings for the period, it is usually preferable to check or call back the postings from the ledger into the books of original entry.

Answer to Question 31--The effect of this procedure on the balance sheet has been to overstate continuously the assets and net worth. If the value of the inventory remained practically the same from year to year, the profits for any one year would be substantially correct.

Answer to Question 32--The cost price will be placed on the inventory sheets and the total inventory thus arrived at carried as a credit to the Trading account and as a debit to the Inventory account in the usual way. If the fall in market price would affect the probable selling price, it would be desirable to set up a "Reserve for Estimated Shrinkage in Value of Inventories" by debiting Profit and Loss and crediting the reserve account for the estimated decrease in value. The operation of a reserve account will be shown later. It may be stated here, however, that on the balance sheet the reserve will be deducted from the cost value of the inventory, while the same amount charged to Profit and Loss will be shown on the statement of profits and income as an extraordinary loss for the period (deducted from Net Profits) and will not be confused with gross profits, which in the example cited will be shown as $15,000.

ANSWERS TO GENERAL REVIEW QUESTIONS

Answer to Question 33--In single entry only the debit or credit, i.e., only one posting, is made for each transaction. In double entry there must be a DEBIT FOR EVERY CREDIT and two postings must be made in the ledger for every transaction in order to balance the books. In single entry, a trial balance cannot be drawn off to prove the accuracy of the work as in the case of double entry. In single entry, record is kept usually of only the personal accounts; in double entry a record is kept of every element of the business.

Answer to Question 34--Prepare a statement of the assets and liabilities ascertained from all sources available. Then make a journal entry--

Assets (in detail)	$---------	
To--Liabilities (in detail)		$---------
Capital Account		---------

or make two entries, viz.:

Assets (in detail)	---------	
To--Capital Account		---------
Capital Account	---------	
To--Liabilities (in detail)		---------

The balance in the capital account represents the net worth of the proprietor.

Answer to Question 35--

(a) By the asset and liability method. A schedule of assets and liabilities at the end of the period is prepared from all available sources. The difference between them is the net worth or net insolvency at that date. A similar statement prepared as of the beginning of the period will show the net worth or net insolvency at that time. Any change in the conditions as shown by these statements must have been caused either by:

1. Money put in or withdrawn by the proprietor.
2. Profits or losses made by the business.

The following form can be used to ascertain the net profit or loss for any period:

NET WORTH at the end of the period	$---------
NET WORTH at the beginning of the period	---------
Balance--being increase or decrease in Net Worth	$---------
ADD--Drawings	---------
	$---------
DEDUCT--Additional Capital Contributed	---------
Balance--NET PROFIT OR LOSS for the period	$---------

(b) To find the net profit or loss from a double entry set of books, ascertain:

1. Inventory of merchandise on hand, supplies, etc., at "cost or market, whichever is the lower."
2. Unexpired insurance.
3. Prepaid rent.
4. Interest accrued on notes receivable; also on notes payable and bonds outstanding.
5. Make due provision for uncollectible accounts.
6. Make proper allowance for depreciation of capital assets.

When the inventories have been prepared and all accrued income and expenses are ascertained, make journal entries to record same in the books.

Now close all the nominal accounts into the Profit and Loss account. Transfer the balance in the Profit and Loss account to the Drawing account of the proprietor, in case of a single proprietorship; to the Drawing accounts of the partners in the proportion stipulated by their articles of copartnership, in case of a partnership; to the Surplus account, in case of a corporation. Then close the Drawing accounts into the Capital accounts in the case of both single proprietorship and partnership.

Answer to Question 36--Capital expenditures are those incurred in the acquisition of assets of a permanent nature or additions thereto, not intended for sale; such as buildings, fixtures, etc. They must be for the purpose of increasing the earning capacity of the business and not mere replacements of old assets worn out.

Revenue expenditures are those incurred in the operation of a business in connection with the earning of revenue, or to maintain the capital assets in a state of efficiency, such as labor, material, salaries, etc.

The distinction between capital and revenue expenditures is very important. The former is an asset; the latter an expense. To classify a revenue expenditure item as a capital expenditure will affect the profits by an amount equal to the item wrongly classified. For instance, if a purchase of $100 is made to replace a worn-out typewriter, and the purchase is charged to the fixture account, the profits are overstated $100, because the assets are increased $100 and the expenses are reduced $100. The reverse proposition is also true. If an additional typewriter is purchased and charged to expense instead of fixtures, the profits are understated $100, because the assets are $100 less than they should be and the expenses are $100 greater than they should be. In order to ascertain the TRUE profit for any period, the classification of expenditures as between capital and revenue must be correct.

Answer to Question 37--When a single merchandise account is kept, return sales, being charged to it, are mixed with the purchases; and return purchases, being credited to it, are mixed with the sales. If these items are numerous, it is quite difficult to determine the NET PURCHASES and NET SALES for a period. This is due to the fact that the purchases are debited at cost and return sales debited at selling price. Conversely, sales are credited at selling price, and return purchases are credited at cost. Therefore, separate accounts should be opened for purchases, to which would be credited all returns; and another should be opened for sales, to which would be charged all returns. In fact, separate accounts are usually kept for return purchases, return sales, and allowances on sales so that every element connected with sales and purchases will be properly classified.

Answer to Question 38--A petty cash fund is a certain amount of cash set aside to pay small expense items. This is done in order that all the entries on the cash book may be represented by a check, and all receipts may be daily deposited intact in the bank. When the fund is nearly depleted, a check for the amount disbursed is given to the petty cashier on surrender of all vouchers supporting such disbursements. Thus, the petty cashier should at any time have on hand either cash or vouchers for the full amount of the fund.

The best method of showing same on the books is to open a Petty Cash Fund account in the ledger, charging thereto $100 set aside for this purpose and crediting cash. When a check is given to reimburse the fund, the proper expense accounts are charged and cash credited in the cash book. Thus no change need be made in the ledger account unless the fund is increased or decreased.

Answer to Question 39--

JONES AND BROWN
BALANCE SHEET, DECEMBER 31, 1917

ASSETS			CAPITAL AND LIABILITIES		
CAPITAL ASSETS:			CAPITAL:		
Real Estate		$---------	Jones	$---------	
Plant and Equipment		---------	Brown	---------	
Total Capital Assets		$---------	Total Capital		$---------
CURRENT ASSETS:			CURRENT LIABILITIES:		
Inventories	$---------		Notes Pay.	$---------	
Customers' Accounts	---------		Accounts Pay.	---------	
Notes Receivable	---------				
Cash in Bank and on Hand	---------		Total Current Liabilities		---------
Total Current Assets		---------			
Total All Assets		$---------	Total Capital & Liabilities		$---------

An alternative method is to show the assets in the order of their liquidity, and the liabilities in the order in which they will be met.

JONES AND BROWN
BALANCE SHEET, DECEMBER 31, 1917

ASSETS			CAPITAL AND LIABILITIES		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash in Bank and on Hand	$---------		Accounts Payable	$---------	
Notes Receivable	---------		Notes Payable	---------	
Customers' Accounts	---------		Total Current Liabilities		$---------
Inventory	---------				
Total Current Assets		$---------			
CAPITAL ASSETS:			CAPITAL:		
Real Estate	$---------		Jones	$---------	
Plant & Equipment	---------		Brown	---------	
Total Capital Assets		---------	Total Capital		---------
Total All Assets		$---------	Total Capital & Liabilities		$---------

Answer to Question 40--A trade discount is a deduction from the list price of an article and is usually deducted from the face of the invoice and the NET selling price charged to the customer. No record is ordinarily kept of trade discounts.

In some businesses fluctuations in market prices are adjusted through the amount of trade discount allowed. This is done by establishing a list price (often the price at which the article is retailed) which is higher than any possible market price. Any increase or decrease of the net price at which it is to be sold is made by an adjustment of the trade discount allowed. This method allows of discrimination between customers by giving some an additional per cent without others being aware of it. It saves reprinting of catalogues, as price changes can be made through a circular stating the change in the discounts allowed.

In calculating trade discounts, each additional per cent is calculated on the net amount left after previous discounts are deducted. If the list price is $100 with 10, 40, 7, and 5 off, 10% is deducted from $100, then 40% is deducted from $100 less $10 or $90, making this discount $36, not $40. The others are treated similarly, so that the net selling price is $47.71.

The cash discount is a premium for the prompt payment of a debt and is allowed at the time of payment. Cash discounts are shown on the books. Discount on sales and discount on purchases are usually kept separate. There are several methods of entering cash discounts in the original books of entry:

1. The net amount of cash received or paid is entered in the cash book and the discount charged or credited, as the case may be, through the journal. Where the discounts are numerous, it necessitates a large amount of clerical work in making the entries and posting them to the ledgers.

2. The total amount which should have been received or paid is entered in the cash book and the discount treated as a receipt in case of creditors and a disbursement in case of customers. The objection to this is that two entries are made, and two postings are required the same as in No. 1.

3. A columnar cash book is used and the actual cash received or paid is entered in the first column, and the discount entered in the next column. Under this method, discount on sales is on the receipt side of the cash book and discount on purchases on the disbursement side. This is done to avoid rewriting of the names of creditors and customers. Another advantage is that the cash and discount may easily be compared. The objection is that two postings are required, one for the cash item and the second for the discount.

4. Where a columnar cash book is used, the best method is to enter the total amount which should have been received in one column, the discount allowed in a second column, and the net cash received in a third column. The total of the cash and discount columns is equal to the total of the first column. A similar treatment is adopted for payments to creditors. Its advantages are:

(a) Only one posting need be made to customers' or creditors' accounts.

(b) The discount may be compared with the total sale or purchase from which it was deducted.

Answer to Question 41--Interest is a sum paid or received for the use of money, while a cash discount is an allowance for the prompt payment of a debt within a certain time. Bank discount is the equivalent of interest, being the amount charged by the bank for the loan represented by the note discounted.

Answer to Question 42--

Party from whom received	$---------	
To--Notes Receivable		$---------
Protest Fees		---------
Note of .... due .... not paid and protested.		

Answer to Question 43--The work of posting can thus be divided among several ledger clerks. By the use of controlling accounts on the general ledger the accuracy of each subsidiary ledger can be checked individually. These controlling accounts being summaries of the details in the subsidiary ledger, the general ledger keeper is enabled to prepare financial statements without waiting to obtain trial balances of the subsidiary ledgers.

Answer to Question 44--Open an account in the sales ledger headed "C. O. D. Sales" and give one line to each sale. As the sale is made, enter the name of the purchaser in the explanation column. When the money is received, credit C. O. D. Sales from the cash book, entering the credit on the same line as the original debit. The open items in the account represent the balance therein.

C. O. D. SALES

1917				1917			
Jan. 1	John Jones	1	$25.00				
" 6	Alfred Tonty	1	78.50	Jan. 9	Alfred Tonty	C-3	$78.50
" 9	Richard Ford	3	72.23				

Answer to Question 45--A note is a written promise by one party (called the maker) to another (called the payee) to pay a certain sum of money on demand or at a certain future time. The parties are the maker, payee, and indorser.

Answer to Question 46--A bill of exchange is a written order by one party (called the maker or drawer) on another party (called the drawee) to pay to a third party (called the payee) a certain sum of money at sight or at some future time. The parties are the drawer, drawee, and payee, indorser, and acceptor.

Answer to Question 47--

(a) A note is a PROMISE by one party to pay a second party.
(b) A bill of exchange is an ORDER by one party, directing a second party to pay a third party according to the tenor of the order.
(c) A sight draft is a bill of exchange which is payable on presentment to the drawee by the payee.
(d) A time draft is a bill of exchange which is payable at a certain time after presentment to the drawee and acceptance by him.
(e) A bank draft is a sight draft drawn by one bank on another bank.
(f) A check is a bill of exchange drawn on a bank, payable on demand.

Answer to Question 48--

(a)

Creditor	$---------	
To--Notes Payable		$---------
Our note No. ...... on account.		

(b)

Notes Receivable	---------	
To--Customer		---------
Note No. ...... signed by .... indorsed by		

(c)

Customer	---------	
To--Notes Receivable (face of the note)		---------
Protest Fees (cash paid for protest)		---------
Note of .... received December 31, 1917, due January 31, 1918.		

Answer to Question 49--

(a)

Cash	---------	
Interest Paid	---------	
To--Notes Receivable Discounted		---------
Note of John Doe received July 8, 1917, due September 8, 1917, discounted at City National Bank, 5%.		

(b)

Cash	---------	
Interest Paid	---------	
To--Notes Payable		---------
Discounted our note at 6% at City National Bank.		

Answer to Question 50--

(a)

John Doe	---------	
To--Notes Payable		---------
Accepted draft of John Doe due January 10, 1918.		

(b)

Notes Receivable	---------	
To--Richard Roe		---------
Richard Roe accepted our draft due January 8, 1918.		

(c)

Cash	---------	
To--Customer		---------
Drew sight draft.		

Answer to Question 51--A controlling account is an account kept in the general ledger, consisting of a summary of the items which have been posted in a detail ledger.

CUSTOMERS CONTROLLING ACCOUNT

Total of opening balances per last trial balance	Return sales and allowances
Sales	Cash Received
Dishonored notes, checks, etc.	Notes
Interest	Accounts charged off
Other journal debits	Other journal credits
Cash debits (if any)	Total of closing balances

CREDITORS CONTROLLING ACCOUNT

Cash payments	Total of opening balances per last trial balance
Notes	Purchases
Returns and allowances	Interest
Other journal debits	Other journal credits
Total of closing balances	Cash credits (if any)

Answer to Question 52--

Articles of partnership entered into this 1st day of January, 1917, by and between John Doe, party of the first part, and Richard Roe, party of the second part, witnesseth:

1. The said party of the first part and the party of the second part hereby agree to form a partnership for the purpose of conducting a wholesale dry goods business in the City of Chicago, State of Illinois.
2. The name of said partnership shall be Doe and Roe.
3. Said partnership shall begin on the first day of January, 1917, and continue for five years thereafter, unless sooner terminated by death of either partner or by mutual agreement.
4. Each party shall invest the sum of Twenty-Five Thousand Dollars ($25,-000) to be paid in in cash on or before the first day of February, 1917. In case either party shall fail to pay same in full, interest shall be charged on any deficiency at the rate of 5% per annum, or the partnership may be terminated at the option of the other party to this agreement.
5. Each party hereto shall be entitled to draw an amount not to exceed $200 per month. Interest at the rate of 6% per annum shall be charged on any excess withdrawals made with the consent of the other party. In case withdrawals are made without such consent, the partnership may be terminated at the option of the other party.
6. Profits shall be divided two-thirds (2/3) to the party of the first part and one-third (1/3) to the party of the second part.
7. In the case of the death of either party the estate of the said deceased shall be entitled to such as his capital account appears in the balance sheet at the close of the last fiscal period, together with interest at 6% per annum thereon until the date of his death. In addition thereto he shall receive as good-will, an amount equal to two times his share of the average profits of the three last completed years. The amount due said deceased shall be payable in three annual instalments and be evidenced by notes issued by the surviving partner.

8. At the close of each fiscal year the accounts of this partnership shall be audited by a Certified Public Accountant, and the balance sheet signed by each partner after due inspection. Such auditor shall be appointed by mutual consent. In case no agreement can be reached, the party of the first part shall appoint the auditor the first year and the party of the second part shall appoint the auditor the second year.

9. In case of disagreement as to any of the provisions of this agreement, same shall be referred to a board of arbitrators to consist of one member appointed by the party of the first part, one member by the party of the second part, and a third to be chosen by the two members already appointed.

10. It is mutually agreed that neither party will indorse any note or become surety for any person without the written consent of the other party.

In Witness Whereof, we have hereunto set our hands and seals in duplicate this first day of January, 1917.

Signed, sealed, and delivered in the presence of--

....

(Seal).........................
(Party of the first part)

(Seal).........................
(Party of the second part)

Answer to Question 53--Profits or losses are shared equally unless some other basis is specifically provided by the partnership agreement.

Answer to Question 54--The average investment of each partner during the period under consideration should be determined, and the profits divided in proportion to this average investment. The modus operandi may be illustrated as follows:

SMITH'S CAPITAL ACCOUNT

1917						
January	1	Invested	$10,000.00	which remained	3 months	$30,000.00
April	1	"	2,000.00			
		Balance	$12,000.00	" "	3 "	36,000.00
July	1	Invested	3,000.00			
		Balance	$15,000.00	" "	2 "	30,000.00
September	1	Invested	4,000.00			
		Balance	$19,000.00	" "	1 "	19,000.00
October	1	Drew	2,000.00			
		Balance	$17,000.00	" "	2 "	34,000.00
December	1	Drew	3,000.00			
		Balance	$14,000.00	" "	1 "	14,000.00
					12 "	$163,000.00

Smith therefore had an average investment of $163,000 for one month, or $13,583.33 for the year.

1917		BROWN'S CAPITAL ACCOUNT		
January 1	Invested	$20,000.00	which remained 6 months	$120,000.00
July 1	Drew	3,000.00		
	Balance	$17,000.00	" " 2 "	34,000.00
September 1	Drew	4,000.00		
	Balance	$13,000.00	" " 3 "	39,000.00
December 1	Invested	3,000.00		
	Balance	$16,000.00	" " 1 "	16,000.00
			12 "	$209,000.00

Brown therefore had an average investment of $209,000 for one month or $17,416.67 for the year.

Smith's average investment (as above)	$163,000.00
Brown's " " (" ")	209,000.00
Total	$372,000.00

Therefore Smith is entitled to 163/372 and Brown to 209/372 of the $22,500 profits, or $9,858.87 and $12,641.13 respectively.

The following method of ascertaining the average investment gives the same results:

1917	SMITH'S CAPITAL ACCOUNT		
January 1	Invested $10,000.00 for 12 months	$120,000.00	
April 1	" 2,000.00 " 9 "	18,000.00	
July 1	" 3,000.00 " 6 "	18,000.00	
September 1	" 4,000.00 " 4 "	16,000.00	
	Total invested for one month		$172,000.00
October 1	Drew out $2,000.00 for 3 months	$ 6,000.00	
December 1	" 3,000.00 " 1 "	3,000.00	
	Total drawn out for one month		9,000.00
	Average investment for one month		$163,000.00

1917	BROWN'S CAPITAL ACCOUNT		
January 1	Invested $20,000.00 for 12 months	$240,000.00	
December 1	" 3,000.00 " 1 "	3,000.00	
	Total invested for one month		$243,000.00
July 1	Drew out $3,000.00 for 6 months	$ 18,000.00	
September 1	" 4,000.00 " 4 "	16,000.00	
	Total drawn out for one month		34,000.00
	Average investment for one month		$209,000.00

Answer to Question 55--In a sale, the title to the goods passes to the purchaser at the time of sale. In a consignment, title remains in the consignor until the goods are sold by the consignee, even though the goods are temporarily in the possession of the consignee. Where a sale is made the seller has a civil claim for the purchase price. He must wait until the claim is due according to the terms of the sale before any collection can be made. If the purchaser should become bankrupt in the meantime, he will receive such proportion of the assets as the total of his claim bears to the total of all unsecured claims. Where goods are consigned, they are still the property of the consignor. He is entitled to the value thereof immediately when they are sold and can recall the goods when he pleases or transfer them to another consignee. If the consignee should become bankrupt, he is entitled to the actual goods and does not have to share the value thereof with other creditors. If the consignee does not remit when the goods are disposed of, the consignee is criminally liable for conversion. Where goods are sold, the seller must ascertain the purchaser's ability to pay; where the goods are consigned, the consignor is concerned only with the honesty of the consignee.

On the other hand, the consignor may be willing to sell but the consignee may not be willing to buy, because he doubts his ability to pay for same when due, or that the goods are salable, although he is willing to give them a trial. If he purchases outright, he must pay whether the goods have been sold or not. If he receives them on consignment, he pays when the goods are disposed of and the consignor takes the risk of their salability.

Answer to Question 56--Capital assets are those of a permanent nature, with which the business is being conducted, such as real estate, machinery, etc. Current assets are those in which the business is dealing, or the result of the conversion of such assets. Examples are inventories, accounts receivable, cash, etc. Floating assets are the same as current assets. Fixed assets are the same as capital assets. Liquid assets are those which can easily be converted into cash, such as marketable stocks and bonds, notes, accounts, etc. Sometimes the inventory is a liquid asset. Liquid assets are often called quick assets.

Capital liabilities are the more or less permanent contributions to the operation of a business; such as partners' investment, or stock issued, or long-time mortgage obligations. Current liabilities are those which must be met within a short period of time, such as notes payable, accounts payable, etc. Fixed liabilities are the same as capital liabilities. Floating liabilities are the same as current liabilities.

Answer to Question 57--Inventories should be valued at "cost or market, whichever is the lower." The reason for this is that no profits can be anticipated, but all losses must be provided for. If purchases have been made on a falling market, it is not conservative to place a higher value on an inventory item than the price at which the same thing can be duplicated in the open market. It may seem inconsistent to advocate a somewhat different principle when purchases have been made on a rising market and where goods cannot be duplicated, except at a higher price. In this case, however, the conservative course is to carry the items at cost and thus do away with the objectionable practice of anticipating profit. No profit is earned until a sale is made to a solvent debtor. Duty and freight paid may be added.

"A practice which deserves condemnation is that of pricing finished goods at sales prices, less an estimated cost of delivery. This anticipates the entire profit on such sales, for it cannot be said that a profit is ever earned until delivery has been made and a cause of action established against a solvent debtor. The fact that goods may be made up on the order of a responsible purchaser in no way alters the principle. Until delivery has been made and the goods accepted, the sales contract is not complete. It is not uncommon for orders to be cancelled or goods refused for so many reasons that they cannot be enumerated here. Therefore, no conservative manufacturer or other business man considers that any profit is earned on undelivered goods." (Montgomery--Auditing)

Discussing the same point, A. Lowes Dickinson says: "Perhaps one of the most difficult questions which accountants have to decide is the correct enumeration and valuation of stocks on hand. The theory governing the valuation of this asset is that, inasmuch as no profits can be realized until the goods are actually sold, it is not safe to take credit for any profit thereon until a sale has been effected; that therefore it should be carried forward at the exact cost and no profit thereon brought into the accounts of the fiscal period. On the other hand, it may be found that the prices both of the raw materials and the finished product have at the close of the fiscal period fallen below their cost, and while it is impossible to say until the goods have been sold whether any loss will ultimately be sustained thereon, at any rate there is a possibility thereof. It is therefore conservative to set aside a sufficient reserve out of profits which have been realized on goods already sold to provide for the accruing loss on those which remain on hand. Hence the general rule for valuation of stocks on hand, namely, 'cost or market, whichever is the lower,' has been evolved and is adopted by the most conservative commercial institutions."

Solution to Assignment I-14-3 Exhibit A

MILLER BROS.

BALANCE SHEET, APRIL 30, 19--

ASSETS

CAPITAL ASSETS:			
Delivery Equipment		$ 1,750.00	
Warehouse and Office Fixtures		1,450.00	$ 3,200.00
CURRENT ASSETS:			
Inventory of Merchandise	$35,890.00		
Consignments	3,200.00	$39,090.00	
Miscellaneous Supplies		300.00	
Advances on Consignments-Inward		1,100.00	
Customers' Accounts		35,542.00	
Notes Receivable	$10,100.00		
Less--Notes Receivable Discounted	10,000.00	100.00	
Cash	$ 3,676.84		
Petty Cash Fund	100.00	3,776.84	79,908.84
PREPAID EXPENSES:			
Unexpired Insurance		$ 50.00	
Rent Paid in Advance		200.00	250.00
			$83,358.84

LIABILITIES AND CAPITAL

CAPITAL ACCOUNTS:		
Fred Miller:		
Balance, March 1, 19--	$15,000.00	
Profit for March and April	2,835.23	
	$17,835.23	
Less--Withdrawals	210.00	$17,625.23
August Miller:		
Balance, March 1, 19--	$15,000.00	
Profit for March and April	1,417.61	16,417.61
CURRENT LIABILITIES:		
Accounts Payable	$36,080.00	
Notes Payable	10,000.00	
Bank Loan	3,000.00	
Taxes Accrued	200.00	
Interest Accrued on Notes Payable	36.00	49,316.00
		$83,358.84

MILLER BROS.
STATEMENT OF PROFIT AND LOSS
TWO MONTHS ENDING APRIL 30, 19--

	AUTOS	ACCESSORIES AND SUPPLIES	TOGETHER
GROSS SALES	$42,312.00	$60,165.00	$102,477.00
LESS--Return Sales	$ 2,000.00	$ 1,710.00	$ 3,710.00
Allowances on Sales	200.00	10.00	210.00
Freight-Out	85.00	100.00	185.00
Total Deductions from Sales	$ 2,285.00	$ 1,820.00	$ 4,105.00
NET SALES	$40,027.00	$58,345.00	$ 98,372.00
Cost of Sales (Exhibit C)	26,300.00	49,330.00	75,630.00
GROSS PROFITS FROM SALES	$13,727.00	$ 9,015.00	$ 22,742.00
ADD--GROSS PROFITS ON CONSIGNMENTS:			
Consignments-Outward		$ 3,200.00	
Consignments-Inward		2,820.00	6,020.00
GROSS PROFITS FROM OPERATION			$ 28,762.00
SELLING AND ADMINISTRATIVE EXPENSES:			
Salesmen's Salaries and Commissions		$10,840.00	
Salesmen's Traveling Expenses		300.00	
Miscellaneous Selling Expenses		1,544.00	
Delivery Expenses		878.00	
Advertising		5,150.00	
Insurance Expense		10.00	
Office Salaries and Expenses		5,495.00	
General Expenses		162.00	
Rent		200.00	
Taxes		200.00	24,779.00
NET PROFITS FROM OPERATION			$ 3,983.00
MISCELLANEOUS INCOME:			
Interest Received		$ 87.34	
Discounts on Purchases		864.50	951.84
			$ 4,934.84
LESS--Interest paid		$ 178.00	
Discounts on Sales		504.00	682.00
SURPLUS NET PROFITS (carried to Exhibit A)			$ 4,252.84
To be divided as follows:			
Fred Miller 2/3		$ 2,835.23	
August Miller 1/3		1,417.61	
		$ 4,252.84	

MILLER BROS.
STATEMENT SHOWING COST OF SALES
TWO MONTHS ENDING APRIL 30, 19--

	AUTOS	ACCESSORIES AND SUPPLIES	TOGETHER
PURCHASES	$47,800.00	$55,570.00	$103,370.00
Freight-In	500.00	360.00	860.00
	$48,300.00	$55,930.00	$104,230.00
LESS--Return Purchases		3,600.00	3,600.00
NET PURCHASES	$48,300.00	$52,330.00	$100,630.00
LESS--Increase in Inventories	22,000.00	3,000.00	25,000.00
COST OF SALES (carried to Exhibit B)	$26,300.00	$49,330.00	$ 75,630.00

COMPLETE ACCOUNTING COURSE--PART I

Lecture 16

CORPORATIONS; VENDOR'S PROCEDURE UPON SALE OF SINGLE PROPRIETORSHIP OR PARTNERSHIP TO CORPORATION

Problem 13

The following is the balance sheet of Smith & Williams at December 31, 1917:

SMITH & WILLIAMS
BALANCE SHEET, DECEMBER 31, 1917

ASSETS

CAPITAL ASSETS:			
Real Estate		$6,000.00	
Furniture & Fixtures		1,790.00	
Total Capital Assets			$ 7,790.00
CURRENT ASSETS:			
Merchandise		$6,713.00	
Accounts Receivable		8,552.00	
Notes Receivable		9,009.00	
Cash in Bank	$6,790.24		
Cash on Hand	43.76	6,834.00	
Total Current Assets			31,108.00
Total All Assets			$38,898.00

CAPITAL AND LIABILITIES

CAPITAL:		
Fred Smith	$20,000.00	
Amos Williams	15,000.00	
Total Capital		$35,000.00
CURRENT LIABILITIES:		
Notes Payable	$ 2,000.00	
Accounts Payable	1,898.00	
Total Current Liabilities		3,898.00
Total Capital and Liabilities		$38,898.00

The Grocers' Company was organized under the laws of the state of Maine with an authorized capital stock of $75,000 divided into 750 shares, par value $100 each. Smith and Williams transfer their net assets and good-will in exchange for $50,000 payable in stock.

Prepare the entries necessary to wind up the books of the partnership.

MISCELLANEOUS QUESTIONS

Question 58--Outline the essential differences between a partnership and a corporation.

Question 59--If, in Problem 13, the Grocers' Company paid $30,000 in stock for the net assets of Smith & Williams, what disposition would you make on the books of the firm of the difference between book value and purchase price?

Question 60--What are some of the reasons why a corporation might wish to pay less (measured in terms of par value of capital stock given in exchange) than the book value of the net assets taken over from a firm?

Question 61--What is your understanding of the terms "vendor" and "vendee"? Illustrate their use.

WORK TO BE DONE IN THE PRACTICE SET

The business having proven profitable, Miller Bros. decide to expand their selling organization and to engage also in the manufacture of motor cars. To secure the necessary capital they organize a corporation in conjunction with P. J. Kirkwood. At a meeting of the organizers Mr. Kirkwood, who was in charge of the legal work, reports as follows:

The Miller Motor Car Co. is to be incorporated under the laws of the state of New Jersey, with an authorized capital stock of $200,000, divided into 7% preferred stock $100,000 and common stock $100,000.

He also reports that he has secured the following subscriptions:

7% PREFERRED STOCK			COMMON STOCK		
Fred Miller	250	shares	Fred Miller	366	shares
August Miller	250	"	August Miller	134	"
P. J. Kirkwood	150	"	P. J. Kirkwood	100	"
B. F. Goodrich Co.	120	"	S. K. Stevenson	100	"
A. J. Smallton	130	"	Fred Higgins	150	"
S. K. Stevenson	100	"	Frank Holloway	150	"
	1,000	"		1,000	

Fred Miller submitted a proposition from Miller Bros. offering to transfer by bill of sale, the net assets and good-will (which is valued at $66,000) of Miller Bros. in consideration of $100,000 to be paid in the stock of the Miller Motor Car Co., as follows:

7% Preferred Stock	500	shares
Common Stock	500	"

In event the adjusted balance sheet of Miller Bros. shall show net assets in excess of or below the said $100,000, such excess or deficit shall be adjusted by a payment of cash to or by the company, as the case may be.

The proposition was accepted, the transfer effected, and stock certificates issued.

Fred Miller instructs you to make the entries required to transfer the net assets to the Miller Motor Car Co. in accordance with the foregoing agreement. Preliminary thereto it will be necessary to set up on the books of Miller Bros. the asset of good-will.

CORPORATIONS

DEFINITION--A corporation is an artificial person created by law for certain purposes which are stated in its charter. It is an organization of persons specially authorized by law to act as one person. It must be borne in mind that it is an artificial entity, separate and distinct from any of its stockholders.

DISTINGUISHED FROM A PARTNERSHIP--A partnership is a contract relation between two or more individuals. The law recognizes only the individuals, and the relation binds only the partners themselves. A corporation, as such, is distinct from its stockholders; the law recognizes the corporation, not the stockholders. This distinction is illustrated in the case of title to real estate. A partnership, as such, cannot buy or sell real estate, for the law does not recognize it. One of the partners must buy or sell it on behalf of the firm. In the case of a corporation, all of its stockholders together could not buy or sell its real estate, for the law does not recognize them. The corporation, as a corporation, must buy or sell.

KINDS--Corporations are divided into two broad classes: public and private. The former is composed of municipal corporations (cities and villages) and quasi-municipal corporations (counties and subdivisions of the state). Private corporations consist of stock and non-stock corporations, the former made up of all corporations organized for profit (including public utilities or "quasi-public" corporations), the latter of clubs, fraternal organizations, mutual societies, charitable institutions, etc.

FORMATION--In the United States corporations must be organized under the laws of a state, territory, or the federal government. These laws differ materially in some instances and offer various advantages and disadvantages to businesses incorporated under them. Corporations carrying on their main operations in one state may be incorporated, because of more favorable laws, in another.

The "charter" of a corporation consists of a document filed by the promoters of the corporation (called commissioners) with the secretary of state or other designated officer, setting out certain points required by law which usually are:

1. Name
2. Object
3. Kinds of stocks, amounts and numbers of shares
4. Place of business
5. Life of corporation
6. Names of incorporators (commissioners)

The charter having been approved by the secretary of state a "certificate of complete organization" is issued to the commissioners.

ADVANTAGES OF INCORPORATION--The chief advantages of incorporation are:

ABILITY TO SECURE GREATER CAPITAL--Many enterprises will not be floated by a single individual because he may be unwilling to risk his entire property under a partnership organization or in a joint-stock company. Corporate organization offers an attractive investment both for the small capitalist and for the larger capitalist. The former can invest small amounts while the latter can divide the risk of his investments over a wider field without the attendant problems of management.

PERMANENCE. A partnership is automatically dissolved by the death or retirement of one of the partners unless otherwise provided in the partnership agreement. A corporation exists for the term stated in the charter unless sooner dissolved by vote of the stockholders. It is independent of the death of any of its owners, or any change in the list of stockholders.

IMPROVED ORGANIZATION. The authority to be exercised by the various officers and board of directors is much more clearly defined in the corporate organization than in the partnership. Business may be done only with duly qualified officers; no stockholder, as such, has power to transact business with outsiders.

TRANSFERABILITY. A partner cannot dispose of his interest without the consent of the other partners nor can he pledge his interest as security. The holder of corporation shares can sell them whenever and to whom he pleases and can also pledge them as security.

LIMITED LIABILITY. The liability of a stockholder (except in special cases) is limited to the amount of his original investment as indicated by the par value of the shares he holds, while that of a partner extends to his entire private fortune.

DISADVANTAGES OF INCORPORATION--Some of the disadvantages of incorporation are:

LIMITED CREDIT. A corporation may find itself embarrassed after its organization, in that creditors, though willing to extend credit to the old firm with its unlimited liability, may hesitate to extend the same credit to the new organization with its liability limited to the investment of its owners, and in many cases the officers as individuals are required by creditors to indorse the company notes.

RESTRICTED POWERS. The charter of a corporation definitely limits its powers, and the consent of the state must be obtained for any change therein. Thus, in Illinois, a corporation cannot deal in real estate nor can it purchase shares of another corporation. The present tendency is to form corporations with broad powers and the importance of this restriction is lessening.

GOVERNMENTAL SUPERVISION. The increasing control by state and federal boards over private corporations is a factor to be considered in some cases. The burdens imposed by the government in the way of reports, fees, taxes, and supervision in general may prove burdensome.

STOCKHOLDERS--Stockholders are the owners of the corporation, corresponding to the partners in a partnership. Their relation to the business is very different, however, from that of partners since they take no active part (except as directors or officers) in its operation. Their evidence of ownership is the "shares" or stock of the corporation which may be transferred at the will of the owner. Stockholders have the right, at common law, to make the by-laws of the corporation, and to elect a board of directors who are responsible to the stockholders for the manner in which the corporation is operated. The by-laws of a corporation may be originated or changed by the board of directors without consent of the stockholders where such authority is granted to the board by the laws of the state, or by the charter or by action of the stockholders.

BOARD OF DIRECTORS--Directors are in general responsible for the direction and management of the corporation's affairs. Their powers and duties are outlined by the by-laws. Officers are appointed by them and the directors must pass upon all transactions of the business outside the scope of authority of the officers.

OFFICERS--The number of officers, their titles and responsibilities vary in different kinds of corporations. Their combined duties are to operate the corporation in accordance with the provisions contained in the charter and by-laws and with the powers delegated to them by the board of directors.

BY-LAWS--In order that the organization may be well defined and the relations, duties, and rights of officers clearly understood, by-laws are enacted containing a definite statement of these matters. The following points are usually covered:

1. When and where annual meeting of stockholders will be held
2. Number of directors, when they are to be elected, and place of their meetings
3. Officers and their duties
4. Salaries
5. Depositories
6. Provisions governing transfer of stock
7. Seal

VENDOR'S PROCEDURE UPON SALE OF SINGLE PROPRIETORSHIP OR PARTNERSHIP TO CORPORATION

The procedure to be followed in case the net assets of a single proprietorship are transferred to a partnership has been shown in I-8-3. The procedure to be followed in case the sale had been made to a corporation would depend somewhat on the manner in which the transaction was effected. Generally, a formal bill of sale is prepared which specifies the assets to be transferred, the liabilities to be assumed, the valuations upon which the sale is made, and the manner in which payment is to be made by the vendor. The more common cases to be dealt with are:

1. Assets transferred at a different valuation from that appearing on the books of the vendor.
2. Assets transferred at a lump sum valuation which includes good-will.

CASE 1--The assets may be sold at a greater or less valuation than the book figures. The first step is to adjust the book figures to the new valuations, the contra debit or credit being made to Profit and Loss account inasmuch as this is a realized profit or loss. The assets as revalued are then transferred to the vendee and entry made for the consideration received.

(1)

Various Assets (in detail)	$--------	
To--Profit and Loss		$--------
To adjust the book figures to the valuations set out in bill of sale dated .... (Note: Losses upon various assets would be credited to the asset accounts and charged to Profit and Loss.)		

(2)

Vendee	--------	
To--Assets(in detail)		--------
To record transfer of assets to .... as per bill of sale dated		

(3)

Liabilities (in detail)	---------	
To--Vendee		---------
To record assumption of liabilities by Vendee.		

(4)

Cash, Stock, or Other Consideration	---------	
To--Vendee		---------
To record receipt of payment in full for net assets transferred.		

(5)

Capital Account	---------	
To--Cash, Stock, or Other Consideration		---------
To record distribution of assets on hand.		

CASE 2--Where the net assets are sold for a lump sum which is in excess of the book valuation, and such excess cannot be attributed to any one or more of the assets disposed of, it is evident that an intangible asset, which may be called Good-will, has also been sold. This frequently occurs where the sale covers not merely the book assets but also the business as a going concern. Assuming the net assets in Case 1 were $30,000, and that the Vendee paid $40,000 for the business as a going concern, the first entry to be made would be:

Good-will	$10,000.00	
To--Profit and Loss (or direct to Capital Account)		$10,000.00
To take up good-will realized on sale of business to		

Entries 2, 3, 4, and 5 would then be made as in Case 1.

If the vendor does not deem it advisable to show the character of the consideration received, entries (4) and (5) may be combined, thus:

Capital Account	$--------	
To--Vendee		$--------
To close Vendee's account. Payment for net assets made directly to		

REFERENCES:

Bentley, "Science of Accounts," pages 31-36
Gilman, pages 284-294
Greendlinger and Schulze, pages, 230-251

COMPLETE ACCOUNTING COURSE--PART I

Lecture 17

CAPITAL STOCK

Problem 14

Referring to Problem 13, prepare the necessary journal entries to open the books of the Grocers' Company.

MISCELLANEOUS QUESTIONS

Question 62--James Brown, William Harper, and Charles Edwards have formed the American Motor Truck Co., with an authorized capital stock of $100,000. Brown subscribes for 500 shares, Harper and Edwards for 250 shares each, cash to be paid in full on allotment. The subscriptions are made January 1, 1917, allotments March 1, 1917.

Prepare the necessary entries to record the above facts.

Question 63--Suppose in the above case Brown, Harper, and Edwards had each subscribed for 250 shares, the balance remaining unissued. What entries would you make?

Question 64--Assume in the case cited in Question 63 that instead of cash being paid in full on allotment, only 50% of the par value is to be paid in cash on allotment, balance to be paid when called for. Wherein would the entries differ?

Question 65--Assuming the facts in Question 62, if Brown, Harper, and Edwards on March 2, 1917, donated 30 shares each to the corporation for the purpose of raising working capital, what entries would be required, the donated stock having been disposed of by the corporation at $90 per share on March 15, 1917?

Question 66--What is the difference between "capital" and "capital stock" of a corporation? Explain in detail.

WORK TO BE DONE IN THE PRACTICE SET

Referring to I-16-2, prepare the opening entries to be made on the books of the Millor Motor Car Co.:

(a) To record the subscriptions.
(b) To record the assets purchased.
(c) To record the liabilities assumed.
(d) To record the payment for the net assets purchased.

Solution to Assignment I-16-2

ENTRIES REQUIRED ON BOOKS OF MILLER BROS.
TO RECORD SALE OF NET ASSETS TO
THE MILLER MOTOR CAR CO.

(1)		
Good-will	$ 66,000.00	
To--Fred Miller--Capital Account		$ 44,000.00
August Miller--Capital Account		22,000.00
To set up value of good-will on sale of net assets to Miller Motor Car Co.		
(2)		
Miller Motor Car. Co., Vendee	159,316.00	
To--Good-will		66,000.00
Delivery Equipment		1,750.00
Warehouse & Office Fixtures		1,450.00
Inventories of Merchandise		35,890.00
Miscellaneous Supplies		300.00
Customers Ledger		35,542.00
Notes Receivable		10,100.00
Advances on Consignments-Inward		1,100.00
Consignment Stock Outward		3,200.00
Cash		3,634.00
Petty Cash Fund		100.00
Unexpired Insurance		50.00
Rent Paid in Advance		200.00
To record the transfer of assets in accordance with bill of sale dated April 29, 19--.		
(3)		
Creditors Ledger	36,080.00	
Notes Payable	10,000.00	
Notes Receivable Discounted	10,000.00	
Taxes Accrued	200.00	
Interest Accrued on Notes Payable	36.00	
Bank Loan	3,000.00	
To--Miller Motor Car Co., Vendee		59,316.00
To record the liabilities assumed by Miller Motor Car Co., per bill of sale.		
(4)		
Miller Motor Car Co.--Common Stock	50,000.00	
Miller Motor Car Co.--Preferred Stock	50,000.00	
To--Miller Motor Car Co., Vendee		100,000.00
To record receipt of payment in full for net assets transferred per bill of sale.		

(5)

Fred Miller--Capital Account	$61,625.23	
August Miller--Capital Account	38,417.61	
To--Miller Motor Car Co.--Common Stock		$50,000.00
Miller Motor Car Co.--Preferred Stock		50,000.00
Cash		42.84

To distribute assets on hand as follows:

	FRED MILLER	AUGUST MILLER	TOGETHER
7% Preferred Stock	$25,000.00	$25,000.00	$50,000.00
Common Stock	36,600.00	13,400.00	50,000.00
Cash	25.23	17.61	42.84
	$61,625.23	$38,417.61	$100,042.84

CAPITAL STOCK

DEFINITION OF CAPITAL STOCK--"Capital Stock" signifies the sum total of certificates of ownership of a corporation expressed in number of shares or in the aggregate "par value" of shares.

VALUE--The PAR VALUE of a share of stock is the amount appearing on its face and is known also as its "nominal" value. Thus, a corporation when organized is authorized to issue a limited number of shares of a stated par value. In certain states the par value must not exceed specified limits; in Illinois the par value must not be less than $10 per share nor greater than $100 per share. In a few states, notably New York, shares may be issued without par value under certain conditions. The BOOK VALUE of capital stock is the net work of the corporation "per books" (Capital Stock and Surplus). MARKET VALUE of stock is the price which it will yield when sold on the market. No two of these three values need be alike.

KINDS OF CAPITAL STOCK--There are two general classes of capital stock:

1. COMMON STOCK. Common stock is the ordinary stock of a corporation, having no special privileges. When the stock of a corporation is all of one kind, it is common stock.

2. PREFERRED STOCK. Stock issued under conditions whereby it is entitled to special privileges: for instance, to receive a specified dividend to be paid out of profits before any dividend can be paid on common stock. Preferred stock may be cumulative or non-cumulative, voting or non-voting, and, in case of liquidation, preferred as to assets over common stock or not preferred as to assets. If preferred stock is cumulative, the specified dividend for each year during which the stock is outstanding must be paid before common stock may receive a dividend.

Since preferred stocks vary greatly, the face of each stock certificate should plainly indicate its character. In case this information is absent, or obscure, it has been held that "preferred stock" is cumulative as to profits but not preferred as to assets in case of liquidation. There may be several classes of preferred stock in the same corporation, such as "First Preferred," "Second Preferred," etc.

PAYMENT FOR CAPITAL STOCK ISSUED--Stock may be paid for in either one or all of three ways: (1) by cash; (2) by property transfers; and (3) by labor or service.

SUBSCRIPTIONS--Stock subscriptions are enforceable promises in writing to pay on a certain agreed date or dates or to pay upon "call" or demand an amount usually equaling the par value of a certain number of shares. Only after a certain number of shares have been subscribed for and a certain amount paid in (in cash, property, or services) can the corporation, as such, commence business. In Illinois, the law requires that the entire amount of capital stock authorized must be fully subscribed for and at least one-half paid in before the commencement of operations.

Allotment takes place when the subscribers to capital stock are determined upon. Allotment may precede, or be concomitant with, the final payment of subscriptions.

Some states allow the forfeiture of subscriptions past due, the subscriber having been duly notified. In most states the law holds that no portion of the amount already paid in need be refunded unless a subsequent sale of the stock representing the subscription yields a sum in excess of the amount due from the delinquent subscriber.

ACCOUNTING FOR CAPITAL STOCK

1. WHEN ORIGINALLY ISSUED OR SUBSEQUENTLY TRANSFERRED--

(a) SUBSCRIPTION BOOK. The subscription book is a book of original or memorandum entry in which are recorded the names and addresses of the subscribers and the number and par value of the shares subscribed by each. A separate subscription book is kept for each class of capital stock.

(b) SUBSCRIPTION OR INSTALMENT LEDGER. An account is kept for each subscriber, showing as debits the amount of the subscriptions and credits for the payments when made. The Subscriptions account in the general ledger will control this subsidiary ledger. When the stock is paid there will be no further use for this ledger.

(c) STOCK CERTIFICATE BOOK. The stock certificate book is a bound record containing perforated sheets one or more of which are filled out with the name of the stockholder and the number of shares the certificate represents. The certificates are removed at the time of issue and sent to the stockholders as evidence of their proprietorship in the corporation. A stub for each certificate remains in the book; cancelled certificates are pasted to the corresponding stub. The stock outstanding will be represented, therefore, by the "open" stubs in the stock certificate book.

The stock certificate book is kept by the secretary. Where the amount of work is heavy, a "Transfer Agent" (usually a trust company) is appointed.

(d) STOCK LEDGER. In most states the law requires that the capital stock outstanding shall be detailed in a record called a stock ledger. This in any case is necessary where the subscribers are at all numerous. The stock ledger, in effect, is a recapitulation of the stock certificate book. An account is kept with each stockholder. This account is credited for the amount of stock (par value) issued to him and debited for any transfers shown by the transfer book, at which time a credit is made to the transferee's account. The balance of each account shows the par value of the stockholder's holdings and forms the basis for computing the dividends to be distributed.

Separate stock ledgers are kept for each class of stock. Where the amount of work involved is large, a "Registrar" (usually a trust company) is appointed.

(e) TRANSFER BOOK. The transfer of shares requires merely an adjustment between the accounts in the stock ledger. The transfer book is a journal containing the original entries necessary to adjust the accounts and to record the following information:

(1) Date of transfer
(2) Kind of stock transferred
(3) Numbers of certificates surrendered
(4) Numbers of certificates issued in exchange
(5) Number of shares
(6) Name of transferrer
(7) Name of transferee

2. <u>WHEN ORIGINALLY UNISSUED OR ISSUED AND SUBSEQUENTLY ACQUIRED</u>--It is necessary to distinguish carefully the terms used in connection with the shares of the corporation which have been reacquired or never issued:

(a) TREASURY STOCK. Stock which has been fully paid for and has been reacquired by the corporation, through purchase or gift, is known as TREASURY STOCK. On the balance sheet it appears either as an asset (if intended to be resold within a short period of time) plainly labeled and standing between capital and current assets, or deducted (at par) from the capital stock authorized in order to bring out the amount of stock "issued and outstanding." DONATED STOCK (treasury stock acquired through gift) may be distinguished by a separate caption, if desired.

(b) UNISSUED STOCK. Unissued stock refers to stock authorized but as yet unissued. It is merely a ledger account which allows the total authorized issue to be shown on the general ledger. On the balance sheet it <u>must</u> be deducted from the authorized issue.

(c) UNSUBSCRIBED STOCK. Unsubscribed stock differs from unissued stock in that the latter may have been subscribed for but for some reason never issued. The two terms, however, are generally synonymous. On the balance sheet they should be deducted from the authorized capital stock, and are never under any circumstances shown as an asset.

OPENING THE BOOKS OF A CORPORATION

The entries to be made to open the books of a corporation depend upon:

1. The facts in the case.
2. Limiting provisions in the statutes of the state in which the company is organized.

<u>CASE 1</u>--A corporation is capitalized at $100,000, all stock fully subscribed for and the subscriptions paid in full in cash:

(a)

Subscriptions	$100,000.00	
To--Capital Stock		$100,000.00
To record the authorized issue and subscriptions therefor.		

(b)

Cash	100,000.00	
To--Subscriptions		100,000.00
To record receipt of payment in full.		

<u>CASE 2</u>--A corporation is capitalized at $100,000, of which $50,000 has been subscribed for, the subscriber paying one-half in cash and one-half in notes:

(a)

Subscriptions	$ 50,000.00	
Unsubscribed Stock	50,000.00	
To--Capital Stock		$100,000.00
To record authorized capital stock and amount subscribed for.		

(b)

Cash	$25,000.00	
To--Subscriptions		$25,000.00
One-half total subscriptions paid in cash.		

(c)

Notes Receivable	25,000.00	
To--Subscriptions		25,000.00
One-half total subscriptions paid in notes.		

CASE 3--The Lawndale Manufacturing Co. is organized with a capital stock of $400,000, divided into $200,000 7% preferred stock and $200,000 common stock, par value $100 per share. The company buys the net assets of Richards & Harlem, per balance sheet given below, for $400,000, to be paid for in 200 shares of preferred stock and 200 shares of common stock:

RICHARDS & HARLEM
BALANCE SHEET, JANUARY 1, 1917

Plant, Machinery, and Tools	$200,000.00	Richards--Capital Account	$100,000.00
Inventories	50,000.00	Harlem--Capital Account	125,000.00
Other Current Assets	50,000.00	Accounts Payable	75,000.00
	$300,000.00		$300,000.00

ENTRIES ON THE BOOKS OF THE CORPORATION

THE LAWNDALE MANUFACTURING CO.
Organized under the laws of
THE STATE OF MAINE
With an Authorized Capital Stock of
$ 4 0 0 , 0 0 0 . 0 0
divided equally into 7% Preferred Stock
and Common Stock. Par value of Shares $100.00 each

(a)

Unissued 7% Preferred Stock	$200,000.00	
Unissued Common Stock	200,000.00	
To--7% Preferred Stock Authorized		$200,000.00
Common Stock Authorized		200,000.00
To record the authorized capital.		

(b)

Plant, Machinery, and Tools	200,000.00	
Good-will	175,000.00	
Inventories	50,000.00	
Other Current Assets	50,000.00	
To--Richards & Harlem, Vendor		475,000.00
To record the purchase of the assets of Richards & Harlem, per bill of sale dated January 1, 1917. See resolution of Directors (minute book, page............).		

(c)

Richards & Harlem, Vendor	$ 75,000.00	
To--Accounts Payable		$ 75,000.00
To record assumption of the liabilities of Richards & Harlem.		

(d)

Richards & Harlem, Vendor	400,000.00	
To--Unissued 7% Preferred Stock		200,000.00
Unissued Common Stock		200,000.00
To record payment in full for net assets acquired.		

CASE 4--In Case 3 if the stock had all been subscribed for and the property received in payment of the subscriptions, entry (a) would be:

Subscriptions--7% Preferred Stock	$200,000.00	
Subscriptions--Common Stock	200,000.00	
To--7% Preferred Stock		$200,000.00
Common Stock		200,000.00
To record authorized capital and subscriptions thereto.		

and entry (d) recording the payment for net assets acquired would be:

Richards & Harlem, Vendor	$400,000.00	
To--Subscriptions--7% Preferred Stock		$200,000.00
Subscriptions--Common Stock		200,000.00
To record payment of subscriptions in full. See resolution of Board of Directors, minute book, page--.		

CASE 5--If, in Case 3, the agreed purchase price was 100 shares of preferred stock and 100 shares of common stock, the entries from (b) on would be:

(b)

Plant, Machinery, and Tools	$200,000.00	
Inventories	50,000.00	
Other Current Assets	50,000.00	
To--Richards & Harlem, Vendor		$300,000.00
To record purchase, etc.		

(c)

Richard & Harlem, Vendor	75,000.00	
To--Accounts Payable		75,000.00
To record assumption, etc.		

(d)

Richards & Harlem, Vendor	$225,000.00	
To--Unissued Preferred Stock		100,000.00
Unissued Common Stock		100,000.00
Capital Surplus		25,000.00
To record settlement in full for net assets acquired.		

CASE 6--In order to raise working capital, the stockholders donate 200 shares of the 7% preferred stock to be sold on the market for cash and these shares are subsequently disposed of at $80 per share.

Donated (or Treasury) Stock	$20,000.00	
To--Capital Surplus		$20,000.00
200 shares of 7% preferred stock donated to be sold for cash to provide working capital.		
Cash	16,000.00	
Capital Surplus	4,000.00	
To--Donated Stock		20,000.00
200 shares of preferred stock donated sold at $80 per share.		

The Capital Surplus appearing in the last two cases represents the excess of assets over liabilities and capital stock. It is obvious that a business cannot start operations on the purchase of its assets, nor with a profit made up of donations from its stockholders. On the balance sheet Capital Surplus is set out as a separate item between capital and current liabilities or following current liabilities. Capital Surplus is referred to later in a discussion of surplus.

REFERENCES:

Bennett, Chapter XIII
Dickinson, pages 127-133
Esquerre, Chapter IV
Gilman, pages 303-323
Hatfield, Chapters VIII-IX
Klein, pages 115-132, 138-145
Montgomery, pages 133-134, 137

COMPLETE ACCOUNTING COURSE--PART I

Lecture 18

BONDS; VOUCHER SYSTEM

Problem 15

The following balance sheet was prepared by the bookkeeper of the Johnson Shoe Co.:

JOHNSON SHOE COMPANY
BALANCE SHEET, DECEMBER 31, 1917

ASSETS			LIABILITIES		
CAPITAL ASSETS:			CAPITAL STOCK:		
Plant and Equipment	$300,000		Authorized Issue		$250,000
Good-will	50,000	$350,000			
			CURRENT LIABILITIES:		
CURRENT ASSETS:			Mortgage on Plant (due Jan. 1, 1918)	$100,000	
Capital Stock Unissued	$ 15,000		Accounts Payable	40,000	
Capital Stock Repurchased	10,000		Bank Loans	50,000	190,000
Inventories of--					
Raw Materials	25,000		SURPLUS:		
Unfinished Goods	3,000		Balance, Jan. 1, 1917	$20,000	
Finished Stock	12,000		Profits for year	10,000	30,000
Stationery & Supplies	1,000				
Accounts Receivable	44,000				
Cash	10,000	120,000			
		$470,000			$470,000

$150,000 first mortgage 5% bonds were authorized and disposed of for cash at par on December 31, 1917. The purpose of the issue was to pay off the mortgage and bank loans, the former being due on the following day, as indicated, and the latter on various dates in January.

Assuming the method of stating surplus to be correct, rearrange the balance sheet to give expression to the issue of bonds and receipt of cash and to whatever other adjustments you may think necessary to display properly the financial condition of the business on December 31, 1917.

MISCELLANEOUS QUESTIONS

Question 67--A certain issue of bonds is entitled: "Forty-year Convertible Five Per Cent Gold Coupon Bonds." Explain the significance of the terms used.

Question 68--Outline the nature of postings to the Vouchers Payable account under the following situations:

(a) Where the amount column in the voucher register contains the amount appearing on the invoice before deducting the cash discount.

(b) Where the amount column in the voucher register contains the amount of the invoice less cash discount.

Question 69--Explain how the voucher register serves the double purpose of both book of original and of final entry.

Question 70--

(a) Give, in journal entry form (a journal entry need not be made when actually posting, however), the monthly postings from the voucher record of the Miller Motor Car Co., using imaginary figures and omitting some of the distribution columns.

(b) Supposing the register to contain a special column for accounts payable, how would the above entry be modified?

WORK TO BE DONE IN THE PRACTICE SET

Record the entries opening the books of the Miller Motor Car Co., post, and submit a balance sheet of the new corporation at May 1.

MILLER MOTOR CAR CO.
SCHEDULE OF ACCOUNTS
EFFECTIVE MAY 1

	ACCOUNT
101	Land
102	Buildings
102R	Reserve for Depreciation of Buildings
103	Machinery, Tools, and Equipment
103R	Reserve for Depreciation of Machinery, Tools, and Equipment
104	Office and Warehouse Fixtures
104R	Reserve for Depreciation of Office and Warehouse Fixtures
105	Delivery Equipment
105R	Reserve for Depreciation of Delivery Equipment
151	Good-will
201	Investments
251	Subscriptions--7% Preferred Stock
252	Subscriptions--Common Stock
271	Sinking Fund Assets
301	Inventory of Automobiles
302	Inventory of Work in Progress
303	Inventory of Raw Materials
304	Inventory of Finished Parts

	ACCOUNT
306	Inventory of Miscellaneous Supplies
308	Consignment Stock Outward
309	Advances on Consignment-Inward
321	Fred Miller--Personal Account
322	Customers' Accounts
326	Notes Receivable
326D	Notes Receivable Discounted
327	Accrued Interest on Notes Receivable
328R	Reserve for Bad Debts
329R	Reserve for Discounts
351	Cash in Bank
352	Petty Cash Fund
356	Advances to Salesmen
401	Unexpired Insurance
402	Rent Paid in Advance
403	Prepaid Interest on Notes Payable
451	Discount on Common Stock
501	Capital Stock--7% Preferred
502	Capital Stock--Common

502U Unissued Common Stock
551 5% First Mortgage Bonds
551U Unissued 5% First Mortgage Bonds
561 6% First Mortgage Bonds
601 Notes Payable
611 Bank Loan
621 Audited Vouchers
631 Dividends Payable--Common Stock
632 Dividends Payable--Preferred Stock
651 Accrued Interest on Notes Payable
652 Accrued Bond Interest
653 Accrued Taxes
654 Accrued Pay-roll
661 Miller Bros., Vendor
662 Babcock Bros., Vendor
663 Best Automobile Co., Vendor
701 Sinking Fund Reserve
711 Surplus
801 Sales--Automobiles
801A Allowances on Sales--Automobiles
802 Sales--Finished Parts
802A Allowances on Sales--Finished Parts
802D Discounts on Sales--Finished Parts
851 Automobiles--Cost of Sales
852 Finished Parts--Cost of Sales
881 Discount on Purchases
882 Interest Received
886 Consignment Earnings
901 Purchases of Raw Material
902 Purchases of Finished Parts
911 Direct Labor
921 Indirect Labor
922 Repairs--Plant and Equipment
923 Heat, Light, and Power
924 Royalties
925 Shop Supplies
926 Depreciation on Buildings, Machinery, Tools, and Equip.
927 Insurance
928 Taxes
929 Miscellaneous Factory Expenses
941 Salesmen's Salaries
942 Salesmen's Traveling Expenses
943 Advertising
944 Freight-Out
945 Delivery Equipment Maintenance
946 Depreciation of Delivery Equip.
947 Miscellaneous Selling Expenses (including Rent)
961 Depreciation of Office and Warehouse Fixtures
962 Office Salaries
963 Salaries of Officers
964 Stationery and Printing
965 Bad Debts
969 Miscellaneous General Expenses
981 Bond Interest
982 Other Interest Paid
991 Trading Account--Automobiles
992 Trading Account--Finished Parts
996 Profit and Loss
999 Dividends

CUSTOMERS LEDGER

322A District #1
322B District #2
322C District #3
322D District #4
322E District #5
322F District #6
322G District #7
322H District #8

1-account pages 991-2; 996-9
2-account pages 251-2, 271; 309-321; 322-6; 601-611; 621-631
3-account pages, balance

The following books of account will be kept:

1. Six-column Journal (Form 4)
2. Sales Book (Form 5)
3. Return Sales Book (Form 6)
4. Record of Audited Vouchers (Forms 8 and 8-a)
5. Record of Cash Receipts (Form 11)
6. Record of Checks Drawn (Form 12)
7. Ledger pages (Forms 13, 14, and 15)

In addition there may be assumed to exist a stores ledger and other cost records which the student will not keep and which will be explained later.

SUMMARY OF TRANSACTIONS

MAY 1

The board of directors has issued a call for 50% of the unpaid preferred stock subscriptions to be paid in cash today. Receive in response thereto--

P. J. Kirkwood	$ 7,500.00
B. F. Goodrich Co.	6,000.00
A. J. Smallton	6,500.00
S. K. Stevenson	5,000.00
	$25,000.00

In this connection an instalment ledger may be kept and the detail items posted thereto. (Credit "Subscriptions--7% Preferred Stock" in cash book for $25,000.)

MAY 2

In the corporation work the purchase register and creditors ledger will not be used, the audited voucher record replacing them. Accounts formerly carried in the creditors ledger will be transferred to the audited voucher record, as follows:

NO.	DATE	NAME	DETAIL	AMOUNT	DISCOUNT ON PURCH.	SUNDRY ACCOUNTS	GENERAL LEDGER
1	May 1	N. Y. Auto Sup. Co.	Taken over from Miller Brothers	$29,500.00	$------	Audited Vouchers	$29,500.00
2	"	Well-Built Auto Co.		4,850.00	150.00	"	5,000.00
3	"	Star Auto Co.		1,580.00	------	"	1,580.00

(It is assumed that the proper voucher will be made immediately for each purchase whether for cash or on account. All vouchers should be entered in the audited voucher record and the payment recorded in the cash book. No disbursement can be made except by voucher properly prepared.

It is the intention of the company to have sufficient cash on hand to take advantage of all possible cash discounts. Therefore, in entering purchases on the voucher record, the NET amount of the invoice should be entered in the "Amount" column; the cash discount should be entered in the "Discount on Purchases" column; and the TOTAL amount of the bill should be charged to the proper accounts in the distribution columns. Thus at any time the total of the "Amount" and "Discount" columns will be equal to the total of all distribution columns.)

Send check to District Manager #1 for salesmen's traveling expenses, per reports, $168. (Voucher #4 made and check #1 issued.)

Receive from District #1 $110 for C. O. D. shipment to John Lange of April 8.

(For sales purposes the country has been divided into sales districts. In the sales ledger an account will be kept with each district to which all sales therein will be charged and returns credited per the district managers' reports. Charges and credits will be the totals of these reports instead of each individual item as would be the case in actual practice, thus condensing the clerical work. Accounts now on books are in District #1.)

Send check to Well-Built Automobile Co. for $5,000, less the 3% discount allowed by them.

MAY 3

The board of directors has authorized the purchase of the Babcock Bros. automobile plant for $175,000, payable as follows: $5,000 down at date of signing the contract May 3; 2 notes for $10,000 each, due May 31 and June 30 respectively, with interest at 6% per annum; balance to be paid in bonds of this company. By resolution duly carried at a stockholders' meeting a bond issue of $150,000 is authorized, to consist of a serial issue of 15 first mortgage gold bonds for $10,000 each, maturing yearly during 15 years, with interest at 5%, payable November 1 and May 1 (journal). The board has appraised the land at $25,000, buildings $50,000; machinery, tools, etc., $100,000. A voucher is made for $5,000 and check issued. The 15 bonds are issued in favor of Babcock Bros., and also the two notes.

Sold the 2 automobiles of the Midland Motor Co. for $1,500 each to George Heck (District No. 1 account). Sent the following account sales with check for the net proceeds:

ACCOUNT SALES

SALES		$3,000.00
DEDUCT--Commission	$ 300.00	
Freight	100.00	
Advances	1,000.00	1,400.00
NET PROCEEDS remitted		$1,600.00

MAY 4

Received the following shipments:

Stahl Steel Works, Raw Material	$3,286.85	terms	1%	10 days,	net	30 days
Automobile Accessories Mfg. Co. Finished Parts	5,025.00	"	2%	15 "	"	30 "
B. F. Goodrich Co., Finished Parts	1,687.50	"	2%	10 "	"	30 "
Standard Wheel Co., Finished Parts	1,927.80	"	2%	10 "	"	30 "
Washed Coal Co., Heat, Light, and Power	1,836.00	"	2%	10 "	"	60 "

It may be assumed that vouchers have been made on receipt of goods. They should, therefore, be entered at once in the voucher register.

MAY 5

Babcock Bros. have offered to accept $19,850 as full payment of their notes due May 31 and June 30 respectively. A special meeting of the board is called and by resolution the treasurer is authorized to accept same. Whereupon the board authorizes the treasurer to pay the amount by check and issues a call for 50% on the preferred stock and 20% on the common stock, to be paid in cash May 8. (No entry on the general books until cash is received.)

The sales for the week per district managers' reports are:

DISTRICT	CARS	FINISHED PARTS
1	--------	$795.65
3	--------	541.20
4	$6,000.00	286.75

James Garage Co., being unable to sell the two automobiles consigned to them on April 17, returned them. (Debit Inventory of Automobiles account.)

MAY 7

A voucher check is issued to order of "Pay-roll" for the total pay-roll, week ending May 5, as follows:

Direct Labor	$2,871.46
Indirect Labor	1,313.89
Repairs--Plant and Equipment	1,082.75
Heat, Light, and Power	126.00
Salesmen's Salaries	385.00
Office Salaries	87.50
	$5,866.60

Also pay freight bills rendered by Penn. R. R. Co. amounting to $331.26, of which $98.43 is chargeable to Raw Materials and $232.83 to Finished Parts.

Solution to Assignment I-17-1

ENTRIES TO OPEN THE BOOKS OF MILLER MOTOR CAR CO.

MILLER MOTOR CAR CO.
Organized under the laws of
THE STATE OF NEW JERSEY
With an Authorized Capital Stock of
$200,000.00
divided into 1,000 Shares of 7% Preferred Stock
and 1,000 Shares Common Stock, Par Value $100.00

(1)

Subscriptions--7% Preferred Stock	$100,000.00	
To--7% Preferred Stock		$100,000.00

To record subscriptions as follows:

Fred Miller	$ 25,000.00
August Miller	25,000.00
P. J. Kirkwood Co.	15,000.00
B. F. Goodrich Co.	12,000.00
A. J. Smallton	13,000.00
S. K. Stevenson	10,000.00
Total	$100,000.00

(2)

Subscriptions to Common Stock	$100,000.00	
To--Common Stock		$100,000.00

To record subscriptions as follows:

Fred Miller	$ 36,600.00
August Miller	13,400.00
P. J. Kirkwood	10,000.00
S. K. Stevenson	10,000.00
Fred Higgins	15,000.00
Frank Holloway	15,000.00
Total	$100,000.00

(3)

Office and Warehouse Fixtures	1,450.00	
Delivery Equipment	1,750.00	
Good-will	66,000.00	
Inventory of Automobiles	30,000.00	
Inventory of Finished Parts	5,890.00	
Inventory of Miscellaneous Supplies (Stationery and Printing)	300.00	
Consignment Stock Outward	3,200.00	
Advances on Consignments Inward	1,100.00	
Customers Ledger	35,542.00	
Notes Receivable	10,100.00	
Cash in Bank	3,634.00	
Petty Cash Fund	100.00	
Unexpired Insurance	50.00	
Rent Paid in Advance	200.00	
To--Miller Bros., Vendor		159,316.00

To record assets acquired by purchase per bill of sale dated.......... See resolution of Board of Directors dated.......... and recorded in their Minute Book, page.........

properly prepared.

(4)

Miller Bros., Vendor	59,316.00	
TO--Notes Receivable Discounted		10,000.00
Notes Payable		10,000.00
Bank Loan		3,000.00
Audited Vouchers		36,080.00
Interest Accrued on Notes Payable		36.00
Taxes Accrued		200.00

To record the liabilities assumed per bill of sale above referred to.

(5)

Miller Bros., Vendor	$100,000.00	
To--Subscriptions--7% Preferred Stock		$ 50,000.00
Subscriptions--Common Stock		50,000.00

To record the issue of 500 shares of 7% Preferred Stock, par value $100, and 500 shares of Common Stock, par value $100, in full payment for net assets acquired under bill of sale above referred to.

Solution to Problem 13

(1)

Good-will	$15,000.00	
To--Fred Smith		$ 7,500.00
Amos Williams		7,500.00

To record value of good-will on transfer of net assets to Grocers' Company.

(2)

Grocers' Company, Vendee	53,898.00	
TO--Real Estate		6,000.00
Furniture and Fixtures		1,790.00
Good-will		15,000.00
Merchandise		6,713.00
Accounts Receivable		8,552.00
Notes Receivable		9,009.00
Cash in Bank		6,790.24
Cash on Hand		43.76

To record transfer of assets to Grocers' Company, per bill of sale dated.............

(3)

Notes Payable	2,000.00	
Accounts Payable	1,898.00	
To--Grocers' Company, Vendee		3,898.00

To record assumption of liabilities by the Grocers' Company.

(4)

Grocers' Company--Capital Stock	50,000.00	
To--Grocers' Company, Vendee		50,000.00

To record receipt of payment in full for net assets transferred.

(5)

Fred Smith--Capital Account	27,500.00	
Amos Williams--Capital Account	22,500.00	
To--Grocers' Company--Capital Stock		50,000.00

To record distribution of stock to partners.

ANSWERS TO QUESTIONS

Answer to Question 58--

(a) A corporation must secure the consent of the State before engaging in business, and is subject to certain regulations which do not affect a partnership. A partnership may be organized without consulting any public authority. It is simply a contract between the members.

(b) Partners are usually liable for partnership debts to the full extent of their private fortunes, while the owners of the corporation are usually liable only for the amount of their subscriptions.

(c) Partnerships may engage in any business; corporations are restricted to the purposes set forth in their charters.

(d) Each partner is entitled to share in the management. In a corporation the board of directors controls the current operations. In a corporation the stockholders vote in proportion to their holdings for directors who alone have authority over the corporate property and business. These directors appoint officers to transact the business. The stockholders, as such, have no authority in the corporate affairs. Each partner is the agent of the others, and may perform any act within the scope of the partnership and by that act bind the other partners.

(e) Partners cannot dispose of their interests without the consent of the other members. Stockholders can sell their shares of stock at will.

(f) The death, insanity, or insolvency of a member of a firm dissolves the firm. The death, insolvency, or insanity of a stockholder has no effect on the continuity of the life of a corporation.

(g) A corporation has an entity separate from its members. It can sue its members and can be sued by them. Partners cannot sue the partnership of which they are a member, nor can the partnership sue one of its members.

Answer to Question 59--The difference of $5,000 would be a loss to be charged to the partners in accordance with the provision in their partnership agreement covering the division of profits and losses.

Answer to Question 60--

(a) The values of various assets may have been overstated on the books of the firm on account of insufficient provisions for depreciation, failure to distinguish properly between capital and revenue expenditures, over-valuation of inventory, etc.

(b) If the stock is to remain in the hands of a few parties, they may wish to capitalize merely for a nominal amount, the proportionate shares remaining the same whether a high or low capitalization exists.

(c) The earning power of the business might be such as to warrant only the price paid; i. e., the capitalized earning power might be less than the value of the net assets per books. The book figures, however, might still be properly valued from the viewpoint of the going concern, although if the business were liquidated the book values might not be realized.

Answer to Question 61--A vendor is one who by bill of sale transfers property to another. The vendee is the party to whom the property is transferred. The terms are used to differentiate purchases or sales in the ordinary course of business from the occasional purchase or sale of a plant or other large asset or a complete going concern.

BONDS

NATURE OF BONDS--If a corporation borrows money, notes or bonds may be given to evidence the transaction. Notes are usually preferred when one or more of the following conditions are present: (1) a small amount, (2) a few persons willing to advance the sum, or (3) a short period to run. Bonds are superior where the amount (1) is large, (2) is secured from a number of people, and (3) runs for a period of years. Bonds are more formal than notes, are executed under seal, possess a larger degree of marketability, and are usually secured by a lien on property of the borrower. Bonds have a par value similar to capital stock, but the range of par values is much larger, running usually from $100 to $10,000.

Bonds are a direct obligation of the corporation and therefore differ materially from stock. Moreover, interest on bonds must be paid before any dividends can be declared, and in case of liquidation bondholders are usually secured as to principal.

AUTHORIZATION--Unless otherwise provided by statute or by-laws, the power to issue bonds lies in the board of directors. A provision is usually found in the by-laws making necessary the consent of the stockholders in case the issue of bonds necessitates the mortgaging of corporate property.

TRUST DEED--The trust deed is an instrument conveying title of properties of a borrowing corporation to a trustee for the purpose of insuring the rights of bondholders. It contains full details of the contract between corporation and bondholders.

KINDS OF BONDS--In general, bonds may be divided, in terms of negotiability and form, into two classes: coupon and registered bonds.

1. Coupon bonds are usually payable to bearer both as to principal and interest, although in some cases they are registered as to principal. Coupons are the interest warrants attached to the bond and are "clipped" when accrued and treated as cash by banks. The coupons are numbered consecutively.

2. Owners of registered bonds are recorded on the books of the corporation, and any changes in the ownership must also be recorded on its books. This is accomplished by surrendering the old bond, properly indorsed, and receiving a new one in exchange. A registered bond is, therefore, non-negotiable. Interest is paid to the registered bondholders by check.

From the viewpoint of underlying security, bonds may be fully secured, partially secured, or unsecured.

1. The secured bond is the most common type. Its security may be personal property (equipment trust bonds, collateral trust bonds, etc.), real property (terminal bonds, construction bonds, etc.), or both real and personal property (general mortgage bonds, etc.). The security usually extends to both principal and interest.

2. Partially secured bonds are illustrated by income bonds. Here the principal is usually secured by the terms of the trust deed, but interest is wholly dependent on the earning of income by the corporation. The interest may or may not be cumulative.

3. Unsecured bonds are termed "debentures" or debenture bonds. While they are obligations of a corporation, they are not ordinarily secured by a lien or mortgage on particular assets as are the secured and partially secured bonds. If default occurs, either as to principal or interest, debenture bondholders cannot foreclose.

Other types of bonds commonly referred to are:

1. Convertible bond--one which may be converted under stated conditions into some security of the corporation, usually stock.
2. Serial bonds are those which are retired serially--a certain number annually until the entire issue has been redeemed.
3. Consolidated bonds are bonds issued in exchange for various other types of bonds in effecting a simplification of the financial structure.
4. Redeemable bonds are those which may be purchased, under certain conditions, by the issuing corporation, before their normal maturity.
5. Interest bonds are bonds given for interest payments in lieu of cash.
6. Refunding bonds are bonds exchanged for old issues matured or retired.

<u>AMOUNT OF BONDS</u>--Various state laws prohibit the issue of bonds beyond a certain limit. For instance in Illinois the amount of bonds must not exceed the amount of capital stock. In the case of public utilities, most states require that the amounts and kinds of bonds issued must bear the approval of the utilities commission of that state.

<u>ENTRIES REQUIRED</u>--The accounting for bonds is comparatively simple. Bonds may be paid for outright or in instalments. For registered bonds a subsidiary record should be kept, a page being devoted to each registered bondholder. The following cases are illustrative.

Assume that in all these cases, the authorized issue is $500,000. The first entry will, therefore, be:

-July 1, 1917-

Unissued First Mortgage Bonds	$500,000.00	
To--First Mortgage 6% Bonds		$500,000.00
To record authorized issue of 6% Thirty-Year First Mortgage Bonds. See minutes, Board of Directors, page......; also concurrent action at stockholders' meeting held on..............		

<u>CASE 1</u>--Part of the bonds are sold at par for cash:

Cash (as received)	$400,000.00	
To--Unissued First Mortgage Bonds		$400,000.00
To record payment of entire issue disposed of.		

CASE 2--Others of the bonds are sold at par and accrued interest for cash:

-September 1, 1917-		
Cash	$ 50,500.00	
To--Unissued First Mortgage Bonds		$ 50,000.00
Interest Accrued on First Mortgage Bonds		500.00
To record sale of 50 bonds at par and accrued interest.		

CASE 3--If the bonds are subscribed for and paid in instalments:

Bond Subscriptions	$500,000.00	
To--Unissued First Mortgage Bonds		$500,000.00
To record subscriptions to bonds as follows (give details).		
Cash	100,000.00	
To--Bond Subcriptions		100,000.00
To record receipt of first instalment.		

Cases involving discount and premium on bond sales will be taken up later.

VOUCHER SYSTEM

DEFINITION--A voucher system is a method of keeping an orderly record of every expenditure incurred by a business. This system includes the use of a "voucher" supporting each check drawn and a "voucher record" in which the vouchers are entered and summarized.

KINDS OF VOUCHERS--The voucher consists usually of a paper on which are entered the details of the expenditure, including a distribution to the various ledger accounts affected, number of the voucher (vouchers are numbered consecutively), number of the check, and signatures of clerks and officials who have prepared and checked the voucher and approved it for payment. The original invoice and other necessary supporting data are attached to the voucher before it is finally filed away. Before the voucher is paid, it is filed numerically in the "Unpaid Vouchers" file and after payment in the "Paid Vouchers" file. In most cases vouchers are prepared after invoices have been checked and are, therefore, customarily referred to as "audited vouchers." In some cases the voucher is prepared when payment is made; under such circumstances there are no "unpaid audited vouchers."

A "voucher check" is a combined voucher and check, similar in form to the voucher described above, except that the outer face of the voucher now represents a check. The advantage of this form is that the creditor's indorsement receipts both the payment and details thereof. There is an attempt in some cases to have the ordinary voucher receipted by enclosing it with the check sent; however, the voucher may not be returned, or more often not promptly returned, and thus the files will be incomplete.

Vouchers may be made in duplicate, triplicate, etc., depending on the particular system followed.

VOUCHER RECORD OR REGISTER--The voucher register is a book of original entry in which all vouchers prepared are entered in numerical order. The money columns of this register usually consist of an amount column, a discount column, and a series of distribution columns headed by the names of the most common expenditure accounts. Expenditures not falling under these headings are put in a special column, usually at the extreme right of the page, together with the name of the account to be debited opposite the amount.

Postings are made from the voucher record periodically (usually monthly), the amounts posted being the totals of the various distribution columns, except that in the miscellaneous or sundry column at the extreme right each item must be posted individually to the account named. The total of the amount column is posted to the credit of an Audited Vouchers or Vouchers Payable account in the general ledger. The total of the discount column is posted to the credit of Discount on Purchases. That portion of a check representing a discount not taken advantage of will be debited to the Discount or Purchases account.

By providing contiguous to the amount (or Vouchers Payable) column a column headed "Accounts Payable" or "Creditors Ledger," a subsidiary ledger can be maintained for those few creditors with whom running or current accounts are kept. Otherwise, since usually a check is eventually made out for each voucher, the voucher register may serve as a book of final entry by inserting a "Date Paid" or "Check Number" column; the sum of the vouchers not indicated "paid" should equal the balance of the Audited Vouchers (or Vouchers Payable) account in the general ledger.

The discount column may be omitted from the voucher register and in that case would appear in the cash book. This would be desirable if not all discounts are taken advantage of.

REFERENCES:
Bennett, pages 197-251
Esquerre, pages 34-38
Gilman, pages 203-211

[illegible]

COMPLETE ACCOUNTING COURSE--PART I

Lecture 19

RECORDS OF A MANUFACTURING BUSINESS

MISCELLANEOUS QUESTIONS

Question 71--Many manufacturing concerns charge freight-inward direct to the materials accounts. Do you consider this correct accounting practice?

Question 72--A certain manufacturing business builds several machines for its own use. Three methods are suggested as proper for ascertaining the value at which they are to be charged to the Machinery account:

(a) On the basis of prime cost (raw materials and labor).

(b) On the basis of prime cost plus a portion of factory overhead expenses which have been distributed in the usual way.

(c) On the basis of the cost of the machines if purchased on the open market, i.e., manufactured by another business.

What one of these bases, if any, is the correct one, in your opinion?

Question 73--A company purchased a tract of land for $20,000 and erected a factory. Three years later several other companies locating near them paid from 1/3 to 1/2 more for similar tracts. The management desires to raise the book value to $25,000 on the ground that the land is fully worth that sum. The matter is referred to you, as the accountant, for an opinion.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

MAY 8

Receive on account of preferred stock Call No. 2, cash as follows:

P. J. Kirkwood	$ 7,500.00
B. F. Goodrich Co.	6,000.00
A. J. Smallton	6,500.00
S. K. Stevenson	5,000.00
Total	$25,000.00

On account of common stock Call No. 1:

P. J. Kirkwood	$ 2,000.00
S. K. Stevenson	2,000.00
Fred Higgins	3,000.00
Frank Holloway	3,000.00
Total	$10,000.00

District managers report the following collections for the past week:

Cash (District #1)	$2,024.90	
Discounts Allowed (District #1)	34.25	$2,059.15
Notes Receivable (District #1)		3,000.00
Total		$5,059.15

(Enter cash and discount in the cash book, notes receivable in the journal.)

Increase petty cash fund by a check in favor of petty cashier for $100.

MAY 9

Insurance on the factory is taken out from the National Fire Insurance Co. Premium for one year $870, net 5 days.

MAY 10

A national advertising campaign is authorized by a resolution of the board of directors, who appropriate $70,000 for this purpose. The contract is awarded to the U. S. Advertising Co., and an initial payment of $1,000 is made. The remainder will be paid as the monthly bills are received.

MAY 11

Bank reports that the note of the James Garage Co. for $10,000, which was discounted, has been paid.

MAY 12

Received shipments as follows:

B. F. Goodrich Co., Finished Parts	$5,640.00	terms 2% 10 days, net 30 days
Automobile Accessories Manufacturing Co., Finished Parts	7,732.75	" 2% 15 " " 30 "
Standard Wheel Co., Finished Parts	2,099.50	" 2% 10 " " 30 "
Stahl Steel Works, Raw Material	1,787.00	" 1% 10 " " 30 "
Best Drop Forge Works, Raw Material	2,701.25	" 2½% 5 " " 30 "
Specialties Manufacturing Co., Finished Parts	1,202.85	" June 1

MAY 14

Summary of district managers' sales reports for the week:

DISTRICT	CARS	FINISHED PARTS
#1	$ 4,885.00	$ 398.68
2	4,300.00	125.00
3	2,600.00	768.23
4	7,900.00	478.44
5	900.00	95.40
	$20,585.00	$1,865.75

Pay-roll for the week:

Factory:		
Direct Labor	$3,754.32	
Indirect Labor	2,643.12	
Repairs	765.43	
Heat, Light, and Power	138.00	$7,300.87
Office:		
Salesmen's Salaries	$ 412.50	
Office Salaries	115.25	527.75
		$7,828.62

Pay our note for $10,000 in favor of Well-Built Auto Co., with interest for 30 days at 6%. (Charge interest to Accrued Interest on Notes Payable.)

Pay Penn. R. R. Co. $547.28, of which $207.50 is chargeable to Raw Materials and $339.78 to Finished Parts. Also pay the Grand Trunk R. R. $58.75 freight on finished parts. Petty cashier surrenders receipts for $187.50, of which $68 is for stationery and printing, $37.25 for miscellaneous general expenses, and $82.25 for local advertising. Check for $487.50 is issued to him. The $300 additional is for the purpose of increasing the petty cash fund to $500.

MAY 15

Report of collections for the past week:

DISTRICT	CASH	DISCOUNTS ALLOWED	TOTAL CASH CREDITS TO CUSTOMERS	NOTES RECEIVED ON ACCOUNT
#1	$1,465.15	$27.13	$1,492.28	$1,750.00
3	1,647.40	32.18	1,679.58	1,700.00
4	1,304.20	5.96	1,310.16	2,200.00
Total	$4,416.75	$65.27	$4,482.02	$5,650.00

Pay the following bills:

Stahl Steel Works	Invoice of May 4
B. F. Goodrich Co.	" " " "
Standard Wheel Co.	" " " "
Washed Coal Co.	" " " "
National Fire Insurance Co.	" " " 9

MAY 16

Receive shipment of machinery from the Edmond Machinery Co. In accordance with the terms of the purchase, remit check for $2,000 and our note for $3,500 for 30 days, interest at 5%, for the balance of the purchase price. Buy of Williams & Richards, shop supplies, to be delivered immediately, terms net 30 days, amount of invoice $356.25.

MAY 17

Issue check to August Miller to pay salesmen's traveling expenses, per reports rendered, $307.81.

MAY 18

Shipments received from:

B. F. Goodrich Co., Finished Parts	$4,775.00	terms 2% 10 days, net 30 days
Automobile Accessories Manufacturing Co., Finished Parts	6,923.50	" 2% 15 " " 30 "
Specialties Manufacturing Co., Finished Parts	2,882.50	" June 1
New Idea Lamp Co., Finished Parts	827.75	" 2% 10 " " 60 "

MAY 19

Sales for week per district managers' reports:

DISTRICT	CARS	FINISHED PARTS
#1	$ 4,200.00	$1,033.75
2	14,900.00	401.28
3	3,900.00	968.17
4	11,560.00	632.23
5	13,125.00	1,142.75
7	7,000.00	354.50
	$54,685.00	$4,532.68

Pay invoices as follows:

Automobile Accessories Mfg. Co.	Invoice	May 4
Best Drop Forge Works	"	" 12

Borrow $10,000 from the First National Bank. Give our demand note bearing 5% interest.

MAY 21

Pay-roll for week:

Factory:		
Direct Labor	$4,546.32	
Indirect Labor	1,987.30	
Repairs, Plant and Equipment	643.27	
Heat, Light, and Power	128.00	
Unloading and setting up machinery (charge Machinery, Tools, and Equipment)	103.50	$7,408.39
Office:		
Salesmen's Salaries	$ 880.60	
Office Salaries	128.70	1,009.30
		$8,417.69

Freight bills for the week: $87.38 paid to Grand Trunk R. R. Co. and chargeable to Finished Parts; $352.02 paid to the Penn. R. R. Co., of which $57.65 is chargeable to Raw Material and $294.37 to Finished Parts. Best Drop Forge Works have refused to allow the discount taken on their invoice of May 12, as payment was not made within the time limit. Send them check for $67.53.

Solution to Problem 14

THE GROCERS' COMPANY
Organized under the laws of
THE STATE OF MAINE
With an Authorized Capital Stock of
$75,000.00
divided into 750 Shares, par value $100.00 each.

(1)

Unissued Stock	$75,000.00	
To--Capital Stock		$75,000.00
To record the amount of Capital Stock authorized.		

(2)

Real Estate	6,000.00	
Furniture and Fixtures	1,790.00	
Good-will	15,000.00	
Merchandise	6,713.00	
Accounts Receivable	8,552.00	
Notes Receivable	9,009.00	
Cash in Bank	6,790.24	
Cash on Hand	43.76	
To--Smith & Williams, Vendors		53,898.00
To record purchase of assets of Smith & Williams, per bill of sale dated............ See resolution of Board of Directors, recorded in their minute book, page.........		

(3)

Smith & Williams, Vendors	3,898.00	
To--Notes Payable		2,000.00
Accounts Payable		1,898.00
To record assumption of liabilities of Smith & Williams.		

(4)

Smith & Williams, Vendors	50,000.00	
To--Unissued Capital Stock		50,000.00
To record payment in full for net assets acquired from Smith & Williams, per bill of sale dated...........		

ANSWERS TO QUESTIONS

Answer to Question 62--

-January 1, 1917-

Subscriptions	$100,000.00	
To--Capital Stock		$100,000.00

To record subscriptions to authorized capital stock as follows:

James Brown	500	shares
William Harper	250	"
Charles Edwards	250	"
	1,000	"

-March 1, 1917-

Cash	100,000.00	
To--Subscriptions		100,000.00

To record payment in full.

Answer to Question 63--

-January 1, 1917-

Unsubscribed Stock	$ 25,000.00	
Subscriptions	75,000.00	
To--Capital Stock		$100,000.00

To record subscriptions to authorized capital stock as follows:

James Brown	250	shares
William Harper	250	"
Charles Edwards	250	"
	750	"

-March 1, 1917-

Cash	75,000.00	
To--Subscriptions		75,000.00

To record payment in full.

Answer to Question 64--Entry at January 1 would be the same. The entry at March 1, 1917, would be as follows:

Cash	$37,500.00	
To--Subscriptions		$37,500.00

50% paid in.

Answer to Question 65--

-March 2, 1917-

Donated Stock		$9,000.00	
To--Capital Surplus			$9,000.00

The following donations of capital stock are made for the purpose of raising working capital; see action of Board of Directors as recorded in their minutes, page.......

James Brown	30	shares,	par	value	of	$3,000.00
William Harper	30	"	"	"	"	3,000.00
Chas. Edwards	30	"	"	"	"	3,000.00
Total	90	"	"	"	"	$9,000.00

-March 15, 1917-

Cash	8,100.00	
Capital Surplus	900.00	
To--Donated Stock		9,000.00

The shares contributed by James Brown, William Harper, and Chas. Edwards are disposed of at $90 per share.

Answer to Question 66--The capital of a sole proprietorship or partnership consists of the original investment plus the portion of profits not withdrawn from the business and is represented by the capital accounts kept. That is, the capital of a partnership on a certain date is the sum of its capital accounts on that date. In a corporation, however, the profits are kept separate from the capital invested, the profits being put in a Surplus account. Ordinarily, therefore, the capital of a corporation is the sum of its Capital Stock account and Surplus account. But it will be shown later that the capital contributed by the owners of a corporation need not always be expressed by the Capital Stock account (e.g., donated stock creates a "capital surplus" which is part of the contributed capital), nor may the profits remain in the Surplus account.

RECORDS OF A MANUFACTURING BUSINESS

ASCERTAINING THE COST OF GOODS SOLD--In a trading concern there is but one element in the cost of goods sold: the purchase price, to which is added freight-in and other expenses of bringing the goods to the warehouse. In a manufacturing business the following elements should be set out:

1. RAW MATERIAL is the material which must pass through manufacturing processes that alter its original condition before it is ready for sale as a finished product. Its cost is the invoice price to which is added freight, cartage, and other costs necessary to lay the same down in the factory. Where an adequate cost system is provided, a perpetual inventory (see below) of raw materials is kept, controlled usually by a ledger account. That part of materials used which can be allocated to some particular job or process is referred to as "direct material"; the balance may be referred to as indirect material.

2. LABOR is divided into direct (productive) and indirect (non-productive) labor. Direct labor can be allocated to some particular job or process, while indirect labor, such as foremen, repair-men, timekeepers, watchmen, etc., cannot be distributed except over the operations as a whole.

3. INDIRECT FACTORY EXPENSES, BURDEN, or FACTORY OVERHEAD include all other expenses of factory operation outside of direct material and direct labor charges, such as indirect material, indirect labor, supplies, rent, taxes, insurance, depreciation, repairs and maintenance, heat, light, power, etc. Some kinds of indirect expense can be allocated directly to a certain product or process, while others must be distributed over the product as a whole. The correct allocation of indirect expenses forms one of the most difficult problems in cost accounting.

The first two items compose what is called "prime cost," while the sum of all three items is termed "factory cost." Factory cost is the basis of determining the valuation of inventories and cost of goods sold.

General and administrative expenses and selling expenses should not be confused with burden or factory overhead; they correspond to a similar classification in a trading business (see I-14-6) and do not enter into the cost of finished stock sold or on hand.

INVENTORY ACCOUNTS KEPT

A manufacturing business which keeps an adequate record of its costs maintains three inventory accounts: (1) Raw Materials, (2) Work in Process, and (3) Finished Stock. These accounts may appear in the "factory" ledger described below, or in the general ledger.

RAW MATERIALS ACCOUNT

DEBIT	CREDIT
With balance at beginning of period.	With goods returned.
With cost of purchases.	At the end of period with totals of materials issued to operating departments, at the same time debiting Work in Process account, the posting coming from a requisitions journal.
With freight- and cartage-inward.	
With handling and storage costs.	

The balance of the account will be a debit and represents the cost of raw materials on hand and not in process and should agree with a physical inventory of raw materials on hand as well as the total of the accounts carried in a raw materials stores ledger. The latter record is often a card ledger, a card being kept for each class of raw materials. The card is ruled to record the receipts into stock and the deliveries from stock, and provides in some cases for the expression of receipts and deliveries in terms of units of measurement, unit price and cost price, in others merely in terms of the units of measurement.

WORK IN PROCESS ACCOUNT

DEBIT	CREDIT
With balance at beginning of period. With totals of materials issued to operating departments, at the same time crediting Raw Materials account, the posting being made from a requisitions journal. With costs of direct labor, posted from pay-roll book, the contra credit being to Wages Accrued account. With various items of indirect factory expense, at the same time crediting these various expense accounts.	With the totals of the cost sheets representing work completed, at the same time debiting Finished Stock account, the posting coming from a finished stock journal.

The balance of the account will be a debit and represents the work in process at the end of the period. A total of the cost sheets representing work unfinished should equal the balance of this account, as well as a physical inventory of the unfinished work.

FINISHED STOCK ACCOUNT

DEBIT	CREDIT
With balance at beginning of period. With totals of the cost sheets representing work finished during the period, the posting coming from a finished stock journal.	With the cost of goods sold during the period, at the same time debiting Trading account or Cost of Sales account, the posting coming from the sales journal which contains a column headed "Cost of Sales."

The balance of the account will be a debit and represents the cost of goods manufactured and still on hand. This balance should agree with a physical inventory of the finished stock, as well as the total of the accounts carried in a finished stock ledger.

It should be noted that these three accounts are perpetual inventory accounts, the balances of which should represent the physical stocks on hand valued at cost. The controlling accounts are kept in values only; the subsidiary records may be kept in values only, or in quantities only, or in both.

NATURE AND OPERATION OF A FACTORY LEDGER

In the business of the Miller Motor Car Company, the accounts making up a factory ledger appear in the general ledger; this necessitates in a larger business the keeping of a subsidiary ledger called an expense or cost ledger which supports the general ledger accounts. An alternative method is to install a factory ledger which contains the inventory accounts, labor accounts, and factory overhead accounts. A factory ledger, therefore, separates the "cost" records from the "financial" records.

An account in the factory ledger called "General Ledger" indicates its relation to the financial records, while an account called "Factory Ledger" is a general ledger account controlling the factory ledger. Thus, finished stock sold to a customer would call for an entry in the financial records as follows:

Customers' Account	$1,200.00	
To--Sales		$1,200.00
To record sale, etc.		

A special column in the sales book would produce the following entry at the end of the month:

Cost of Sales (or Trading) Account	$1,000.00	
To--Factory Ledger		$1,000.00
To record cost of sales, per cost sheets, etc.		

In the cost records (i.e., a journal kept for the factory ledger) a summary entry at the end of the month would be made, using the cost sheets or special column in the sales books as a basis:

General Ledger	$1,000.00	
To--Finished Stock Account		$1,000.00
To record finished stock sold, etc.		

If for internal reasons it is undesirable to have the costs disclosed to those having access to the sales books, the cost of sales may be summarized separately.

REFERENCES:

Cole, pages 141-150
Dickinson, Chapter IX
Esquerre, pages 173-185
Nicholson, "Cost Accounting," pages 24-32, 120-126

COMPLETE ACCOUNTING COURSE--PART I

Lecture 20

FINANCIAL STATEMENTS OF A MANUFACTURING BUSINESS

Problem 16

The following are trial balances of the general ledger and factory ledger of the Independence Manufacturing Co. at June 30, 1917.

GENERAL LEDGER TRIAL BALANCE
JUNE 30, 1917

Real Estate	$ 15,000.00	
Buildings and Equipment	55,000.00	
Accounts Receivable	44,500.00	
Notes Receivable	6,500.00	
Notes Receivable Discounted		$ 5,000.00
Cash	18,100.00	
Prepaid Interest	300.00	
Unexpired Insurance	580.00	
Capital Stock		75,000.00
Surplus--Balance, May 31, 1917		42,310.00
Bank Loans		10,000.00
Accounts Payable		15,800.00
Taxes Accrued		1,400.00
Factory Ledger	62,150.00	
Sales		56,000.00
Discounts on Purchases		130.00
Discounts on Sales	100.00	
Office Salaries	1,570.00	
General Expense	800.00	
Salesmen's Salaries and Expense	950.00	
Sales Office Salaries and Expense	740.00	
Interest Received		650.00
	$206,290.00	$206,290.00

FACTORY LEDGER TRIAL BALANCE
JUNE 30, 1917

General Ledger		$61,800.00
Raw Materials Account (including opening inventory and purchases)	$40,400.00	
Work in Process (Inventory, May 31, 1917)	4,100.00	
Finished Stock (Inventory, May 31, 1917)	5,800.00	
Factory Supplies	800.00	
Direct Labor	8,550.00	
Superintendence	650.00	
Heat, Light, and Power (including fuel)	1,280.00	
Miscellaneous Factory Expenses	220.00	
	$61,800.00	$61,800.00

Adjusting journal entries have been made in the general journal and posted to the general ledger, before the above trial balance was taken, as follows:

Factory Ledger Account	$250.00	
General Expense	50.00	
To--Taxes Accrued		$300.00
To take up taxes accruing during June.		
Factory Ledger Account	100.00	
To--Unexpired Insurance		100.00
Insurance expired in June, per insurance register.		

No corresponding entries have been made on the factory journal as yet.

Materials issued during the month are shown by the requisitions journal to amount to $38,200. The cost of sales for the month appears in the sales book as $50,100. The total of cost sheets representing stock completed in the month of June is $48,500. Coal on hand amounts to $400. Office salaries unpaid $230. Prepaid interest expired $200.

From the above information prepare:

(a) Entries necessary to close both the factory ledger and general ledger at June 30, 1917.
(b) A balance sheet at June 30, 1917.
(c) A statement of profits and income for the month ending June 30, 1917.
(d) A statement of cost of sales during the same period.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

MAY 22

Collection report for last week:

DISTRICT	CASH	DISCOUNT ALLOWED	TOTAL CASH CREDITS TO CUSTOMERS	NOTES RECEIVED ON ACCOUNT
#1	$ 1,233.75	$ 20.73	$ 1,254.48	$ 2,000.00
2	3,350.28	51.47	3,401.75	5,900.00
3	1,908.17	15.25	1,923.42	900.00
4	2,602.23	43.33	2,645.56	2,500.00
5	3,267.75	47.29	3,315.04	5,000.00
7	964.64	8.13	972.77	2,200.00
	$13,326.82	$186.20	$13,513.02	$18,500.00

The bank notifies us that the 30-day draft drawn on Frank Rice April 21 has been paid by him and credited to our account.

The board of directors issued Call No. 2 for 60% of the common stock, payable in cash May 22. Received in response thereto:

P. J. Kirkwood	$ 6,000.00
S. K. Stevenson	6,000.00
Fred Higgins	9,000.00
Frank Holloway	9,000.00
	$30,000.00

Pay the New York Auto Supply Co., the balance of their account, $29,500.

Pay:	B. F. Goodrich Co.	$5,640.00	less 2%
	Standard Wheel Co.	2,099.50	" 2%
	Stahl Steel Works	1,787.00	" 1%
	Williams and Richards	356.25	

MAY 23

Shipment of tires received from B. F. Goodrich Co., $928.75, 2% 10 days, net 30 days. Received the balance of our contract with the Automobile Accessories Manufacturing Co., $318.75, 2% 15 days, net 30 days. Standard Wheel Co. $1,972.70, 2% 10 days, net 30 days.

MAY 24

Buy of Williams and Richards shop supplies $487.50, terms 2% 5 days, net 30 days. Invoice of Western Printing Co., for advertising $38.29; stationery and printing $422.80; shop forms $165.75; total $626.84 net 30 days.

MAY 25

Receipt of the following shipments is reported:

Best Drop Forge Works, Raw Material	$1,982.50	terms 2½% 5 days, net 30 days
Briscoe Radiator Co., New Style Radiators	2,750.00	July 1

MAY 26

District managers' sales reports:

DISTRICT	CARS	FINISHED PARTS
#1	$11,300.00	$ 946.37
2	5,000.00	1,059.25
3	9,875.00	873.60
4	16,350.00	1,500.43
5	5,495.00	1,983.65
7	8,900.00	387.00
8	4,875.00	625.42
	$61,795.00	$7,375.72

Pay Star Auto Co. $1,580.00.

MAY 28

Pay-roll for week:

Factory:		
Direct Labor	$5,673.25	
Indirect Labor	2,028.13	
Repairs--Plant and Equipment	723.87	
Heat, Light, and Power	207.30	$8,632.55
Office:		
Salesmen's Salaries	$1,028.35	
Office Salaries	175.50	1,203.85
		$9,836.40

Pay freight bills for week to Penn. R. R. Co. on finished parts $181.35. Pay Automobile Accessories Manufacturing Co., invoice of May 12.

MAY 29

Collection report for past week:

DISTRICT	CASH	DISCOUNT ALLOWED	TOTAL CASH CREDITS TO CUSTOMERS	NOTES RECEIVED ON ACCOUNT
#1	$4,273.21	$ 83.27	$4,356.48	$5,000.00
2	3,542.80	60.92	3,603.72	1,500.00
3	2,473.29	43.38	2,516.67	1,875.00
4	7,029.73	103.75	7,133.48	2,900.00
5	4,900.33	92.28	4,992.61	3,000.00
7	4,387.00	89.50	4,476.50	3,500.00
8	819.96	33.15	853.11	2,100.00
	$27,426.32	$506.25	$27,932.57	$19,875.00

Pay:	B. F. Goodrich Co.	Invoice of May	18
	Williams and Richards	"	24

The U. S. Advertising Company presented their bill for $30,738 for May advertising under contract dated May 10, terms 15 days. Finished parts amounting to $20,000 were purchased from the Crown Automobile Company, terms July 1.

MAY 31

Accrued pay-roll to date:

Factory:		
Direct Labor	$3,548.72	
Indirect Labor	1,085.43	
Repairs--Plant and Equipment	263.21	
Heat, Light, and Power	110.05	$5,007.41
Office:		
Salesmen's Salaries	$ 652.50	
Office Salaries	122.00	
Officers' Salaries (month)	1,800.00	2,574.50
		$7,581.91

District managers' sales reports to May 31:

DISTRICT	CARS	FINISHED PARTS
#1	$7,000.00	$ 475.00
2	--------	321.43
3	2,100.00	93.47
4	2,775.00	1,637.28
5	1,875.00	191.40
7	3,750.00	926.42
8	3,500.00	287.00
	$21,000.00	$3,932.00

Petty cash disbursements to date, $220.83, are as follows: prepaid freight on cars sold $103.50; extra help unloading coal $46.50; sundry manufacturing expenses $13.23; local advertising $23.75; maintenance of delivery equipment $10.48; miscellaneous general expenses $23.37. The petty cashier is reimbursed for the total.

Collection report for the last three days:

DISTRICT	CASH	DISCOUNT ALLOWED	TOTAL CASH CREDITS TO CUSTOMERS	NOTES RECEIVED ON ACCOUNT
#1	$ 345.25	$ 5.23	$ 350.48	$--------
2	1,733.22	22.92	1,756.14	--------
3	1,422.92	19.88	1,442.80	--------
4	1,433.47	25.43	1,458.90	--------
5	963.82	17.27	981.09	--------
7	1,049.29	18.68	1,067.97	--------
8	854.78	13.22	868.00	1,000.00
	$7,802.75	$122.63	$7,925.38	$1,000.00

Solution to Assignment I-18-2

MILLER MOTOR CAR CO.
BALANCE SHEET, MAY 1, 19--
ASSETS

CAPITAL ASSETS:			
Warehouse and Office Fixtures	$ 1,450.00		
Delivery Equipment	1,750.00	$ 3,200.00	
Good-will		66,000.00	$ 69,200.00
SUBSCRIPTIONS:			
7% Preferred Stock		$50,000.00	
Common Stock		50,000.00	100,000.00
CURRENT ASSETS:			
Inventories:			
Automobiles	$30,000.00		
Finished Parts	5,890.00		
Miscellaneous Supplies	300.00		
Consignment Stock Outward	3,200.00		
Advances on Consignments-Inward	1,100.00	$ 40,490.00	
Customers' Accounts		35,542.00	
Notes Receivable	$10,100.00		
Less--Notes Receivable Discounted	10,000.00	100.00	
Cash in Bank	$ 3,634.00		
Petty Cash Fund	100.00	3,734.00	79,866.00
PREPAID EXPENSES:			
Unexpired Insurance		$ 50.00	
Rent Paid in Advance		200.00	250.00
			$249,316.00

LIABILITIES

CAPITAL STOCK:		
7% Preferred Stock	$100,000.00	
Common Stock	100,000.00	$200,000.00
CURRENT LIABILITIES:		
Bank Loan	$ 3,000.00	
Audited Vouchers	36,080.00	
Notes Payable	10,000.00	
Interest Accrued on Notes Payable	36.00	
Taxes Accrued	200.00	49,316.00
		$249,316.00

Solution to Problem 15

(1)

Unissued First Mortgage 5% Bonds	$150,000.00	
To--First Mortgage 5% Bonds Authorized		150,000.00
To record authorized issue of bonds; see minutes of Board, page......, and of stockholders, page......		

(2)

Cash	150,000.00	
To--Unissued First Mortgage 5% Bonds		150,000.00
Issue of bonds disposed of at par.		

JOHNSON SHOE CO.
BALANCE SHEET, DECEMBER 31, 1917

ASSETS

CAPITAL ASSETS:		
Plant and Equipment	$300,000	
Good-will	50,000	$350,000
PROCEEDS FROM SALE OF FIRST MORTGAGE 5% BONDS, on December 31, 1917		150,000
CURRENT ASSETS:		
Inventories of--		
Raw Materials	$25,000	
Unfinished Goods	3,000	
Finished Stock	12,000	
Total	$40,000	
Accounts Receivable	44,000	
Cash	10,000	94,000
PREPAID EXPENSE:		
Inventory of Stationery and Supplies		1,000
		$595,000

LIABILITIES

CAPITAL STOCK:		
Authorized		$250,000
Deduct--		
Unissued	$ 15,000	
Purchased	10,000	25,000
Total Issued and Outstanding		$225,000
FIRST MORTGAGE 5% BONDS:		
Issued and Outstanding		150,000
DEBTS PAYABLE FROM PROCEEDS OF SALE OF FIRST MORTGAGE 5% BONDS (per contra)		
Mortgage on Plant	$100,000	
Bank Loans	50,000	150,000
CURRENT LIABILITIES:		
Accounts Payable		40,000
SURPLUS:		
Balance, Jan. 1, 1917	$ 20,000	
Profits for year	10,000	30,000
		$595,000

ANSWERS TO QUESTIONS

Answer to Question 67--The bonds are to run for forty years from the date of issue; they are convertible into some other security of the corporation, probably stock, within the limits specified on the bond; they are to bear interest at the rate of 5% per annum; redemption is to be made in gold coin if demanded by the owner; the bond is coupon in form, that is, interest warrants are attached to the bond and are to be removed as they become due.

Answer to Question 68--

(a) In this case the discount column usually appears in the cash book, since the method is used most frequently where not all cash discounts are taken advantage of. Whether or not the column appears in the cash book or in the voucher register, its total will be posted (1) to the debit of Vouchers Payable account and (2) to the credit of Discounts on Purchases account.

VOUCHERS PAYABLE ACCOUNT

DEBITS:	CREDITS:
Total of vouchers payable column in cash disbursements book.	Total of amount column in voucher register.
Total of discount column in voucher register.	Miscellaneous journal credits.
Miscellaneous journal debits.	

(b) This case differs from (a) in that the total of the cash discount column is not posted to the Vouchers Payable account, being posted to the credit of Discounts on Purchases account only.

Answer to Question 69--The voucher register performs the function of a book of original entry, since it is the record in which the transactions are entered at the time they occur and it contains a record of equal debits and credits which are posted to the ledger. It is also a book of final entry, in that dates or numbers of checks paying the vouchers are transferred to a special column of the register; the register is thus equivalent to a subsidiary ledger, for the total of the "open" items should equal the balance of the Vouchers Payable controlling account.

Answer to Question 70-- (a)

Raw Materials	$15,000.00	
Finished Parts	10,000.00	
Productive Labor	28,000.00	
To--Vouchers Payable		$52,000.00
Discounts on Purchases		1,000.00

Totals of voucher register posted at end of month; all items will be posted in total except the miscellaneous column at the extreme right the details of which will be posted individually to the general ledger.

(b)

Raw Materials	15,000.00	
Finished Parts	10,000.00	
Productive Labor	28,000.00	
To--Vouchers Payable		32,000.00
Accounts Payable		20,000.00
Discounts on Purchases		1,000.00

Totals of voucher register posted at end of month; all items will be posted in total with the exception of the general ledger column as in (a) and with the exception of the Accounts Payable which, besides being posted in total, will be posted as to the individual items appearing therein to the accounts payable ledger.

FINANCIAL STATEMENTS OF A MANUFACTURING BUSINESS

The balance sheet and statement of profit and loss prepared by a manufacturing business do not differ from those of a trading business except in the fact that the cost of sales is made up of the three elements indicated in I-19-8. The merchandise purchased by a trading business is in a finished state ready for sale, while that purchased by a manufacturing business is raw material to which various costs must be added before ready for sale. The object of a cost of sales statement in a trading business is to show the cost of that portion of the purchases which has been sold; in a manufacturing business its object is to show the cost of that part of the goods manufactured which has been sold. It is also desirable to show a statement of the cost of manufacture, whether the finished or partly finished goods have been sold or not. The two statements are frequently combined (see illustration below) into a tabular statement entitled "Statement of Cost of Manufacture and Sales." The statements of the cost of manufacture and of sales are valuable chiefly to the manager of a manufacturing enterprise, in that comparative costs and relative efficiency of various departments can be obtained. If percentages are used in these statements, Net Sales is usually taken as the basis.

As in the case of the statement of profit and loss, the statement of cost of manufacture may be prepared in two ways, the one followed depending on the preference of the accountant. The first may be called the "account" form and the second the "report" or "statement" form.

ACCOUNT FORM OF MANUFACTURING STATEMENT--The account form is essentially a replica of the ledger "Manufacturing Account," if one is kept, and usually appears in connection with the "Manufacturing, Trading, and Profit and Loss Account," illustrated by the following:

ERDMAN MANUFACTURING CO.
STATEMENT OF MANUFACTURING, TRADING, AND PROFIT AND LOSS
YEAR ENDING DECEMBER 31, 1917

MANUFACTURING ACCOUNT

Inventory of Raw Materials, Jan. 1, 1917	$10,122.15	Inventory of Raw Materials, Dec. 31, 1917	$ 7,047.67
Inventory of Partly Finished Goods, Jan. 1, 1917	3,672.01	Inventory of Partly Finished Goods, Dec. 31, 1917	5,879.22
Purchases of Raw Materials	68,090.58	Cost of Finished Goods Manufactured, carried down to Trading Account	86,229.73
Freight on Purchases	3,111.32		
Wages	8,111.03		
Power, Light, and Heat	1,100.50		
Miscellaneous Factory Expenses	3,400.03		
Depreciation	999.00		
Insurance	300.00		
Taxes	250.00		
	$99,156.62		$99,156.62

TRADING ACCOUNT

Cost of Finished Goods Manufactured brought down	$86,229.73	Inventory of Finished Goods Dec. 31, 1917	$ 3,176.89
Inventory of Finished Goods, Jan. 1, 1917	5,238.11	Sales	120,032.03
Freight Allowances on Sales	2,925.09		
Gross Profit carried down to Profit and Loss Account	28,815.99		
	$123,208.92		$123,208.92

PROFIT AND LOSS ACCOUNT

Salesmen's Traveling Expenses	$ 1,425.50	Gross Profit carried down from Trading Account	$28,815.99
Advertising	1,783.03	Interest on Bills Receivable	442.37
Office Rent	700.00	Discount on Purchases	1,301.03
Office Salaries	4,004.50		
Sundry Office Expenses	1,103.92		
Bad Debts	854.83		
Discount on Sales	2,100.75		
Net Profit transferred to Surplus	18,586.86		
	$30,559.39		$30,559.39

If several products are made in the same factory, a manufacturing account may appear for each, or they may be shown in the same account by the use of a columnar ledger page. The form of the manufacturing account shown above may also be rearranged to bring out separately, (1) the cost of raw materials used (providing the inventory of raw materials is separable from the inventory of partly finished and finished goods); (2) the direct labor cost; and (3) the factory overhead.

REPORT FORM OF MANUFACTURING STATEMENT--The following points are clearly indicated by the report form shown below: (1) the cost of manufacture for the period, subdivided into (a) material, (b) labor, and (c) factory overhead cost; (2) the cost of finished product manufactured; and (3) the cost of finished product sold. The last-named may be set out in a separate statement if desirable.

ERDMAN MANUFACTURING CO.
STATEMENT OF COST OF MANUFACTURE AND OF SALES
YEAR ENDING DECEMBER 31, 1917

MATERIALS:			
Inventory of Raw Materials, January 1, 1917		$10,122.15	
Purchases	$68,090.58		
Freight-In	3,111.32	71,201.90	
TOTAL RAW MATERIALS COST		$81,324.05	
Inventory of Raw Materials, December 31, 1917		7,047.67	$74,276.38
DIRECT LABOR			8,111.03
FACTORY OVERHEAD:			
Power, Heat, and Light		$ 1,100.50	
Depreciation		999.00	
Insurance		300.00	
Taxes		250.00	
Miscellaneous Factory Expenses		3,400.03	6,049.53
TOTAL MANUFACTURING COST			$88,436.94
DEDUCT--Increase in Inventory of Partly Finished Goods--			
December 31, 1917		$ 5,879.22	
January 1, 1917		3,672.01	2,207.21
COST OF FINISHED GOODS MANUFACTURED			$86,229.73
ADD--Decrease in Inventory Finished Goods--			
January 1,1917		$ 5,238.11	
December 31,1917		3,176.89	2,061.22
COST OF FINISHED GOODS SOLD			$88,290.95

REFERENCES:

Esquerre, pages 430-446
Gilman, Chapter VII
Greendlinger and Schulze, pages 335-355

COMPLETE ACCOUNTING COURSE--PART I

Lecture 21

RESERVES

WORK TO BE DONE IN THE PRACTICE SET

MAY 31

Adjusting entries should be made in the journal for:

(a) Depreciation at the following rate (per annum): buildings 2%; machinery 10%; office and warehouse fixtures 6%; delivery equipment 15%.
(b) Reserve for bad debts, ½% of gross sales.
(c) Additional taxes accrued $247.67.
(d) Insurance expired $76.67.
(e) Rent expired $50 (charge Miscellaneous Selling Expenses).
(f) Miscellaneous supplies consumed (consisting of stationery) $100.
(g) Interest accrued on notes payable and bonds.

The cost of raw materials used in production during the month, according to total requisitions issued, is $8,754.78.

All the finished parts are purchased, and the summary of parts issued shows that for May a total of $55,101.55 has been used in production, while a total of $14,953.18 has been sold, leaving a balance of $3,724.08 on hand.

Work in progress transferred to finished stock during the month as per cost sheets amounts to $96,232.21.

The automobiles on hand May 1 and the consignment returned have been sold during the month, as well as part of the finished stock of automobiles manufactured amounting to $88,013.96, leaving a balance, agreeing with the cost sheets, of $8,218.25.

ANSWERS TO QUESTIONS

Answer to Question 71--Part of the freight-inward, if prepaid, will have been included in the sales price of the materials purchased or added to the sales price on the invoice, and it is usually not possible or practicable to separate the two elements. Hence freight, when paid by the buyer of the goods, is often debited directly to the purchase accounts.

Answer to Question 72--The second of three methods is one which should be followed, since this represents cost. The first does not take up all of the actual cost and leaves an amount of burden to be absorbed in the cost of other products manufactured, a procedure obviously unfair. The third method, providing the market price exceeds the cost under (b), will include in the valuation of the machines a profit which is not earned; moreover the purpose of the business in building the machines was to effect a saving, else it would have been a better bargain to purchase them. This saving is reflected by a lower depreciation charge during the life of the machines.

Answer to Question 73--Land is continually appreciating in value nearly everywhere, but this fact is not enough to warrant taking up such increase on the books. It is usually considered that the contra credit to the increase in land valuations is not a realized profit and would appear on the books only when realized, i.e., when the land is sold. However, in the case of a revaluation of properties, it might be desirable to give expression to the increase of land values on the books. But the credit should be made to capital surplus rather than to free surplus, in order that unrealized profits may not be distributed through payment of cash dividends therefrom.

RESERVES

A reserve is an account appearing on the balance sheet representing:

1. A valuation account;
2. An appropriation of profits for a special purpose, called a "true reserve"; or
3. A combination of the foregoing.

1. A valuation account, that is, an amount offsetting an asset which has declined in value, is illustrated by a reserve for depreciation, description of which appears below. It is created by a debit to operating expenses, and on the balance sheet is deducted from the asset it offsets. Similar reserves are provided, where necessary, for other assets such as inventories and accounts receivable.

2. "True" reserves are so called because their effect is to "reserve" profits from ordinary surplus available for dividends. Illustrations are found in reserves for contingencies, sinking fund reserves, etc. They are also termed appropriated surplus since they are created out of profits and in reality are a part of the surplus whether shown as such on the balance sheet or not.

3. Reserves for pensions, insurance, accidents, etc., are usually created by a charge against operations (as in case 1) but, unless an actual liability, are nearly equivalent to a division of surplus (as in case 2).

DEPRECIATION

NATURE OF--A distinction between capital and current assets has already been drawn (See I-5-2). This distinction is further indicated when it is said that a capital asset performs many services in a business before its usefulness is impaired or destroyed, while a current asset performs but one service and immediately loses its identity.

Contrast the services yielded, for example, by a machine whose life is five years and 1,000 tons of coal which are expected to last the same length of time. The cost was $3,000 each for both machine and coal, and each is expected to have a scrap or residual value (scrap iron in the case of the machine, and cinders, etc., in the case of the coal) of, say, $200. Both machine and coal yield services, the only distinction being that the physical dimensions of one remain the same; those of the other diminish. The VALUE--dimensions of each are decreasing at precisely the same rate, inasmuch as each

is contributing services or uses to the business. No one would deny that the coal, as consumed in operations, is an expense of those operations; hence, if this is true, it must follow that the machine, consumed in operations, is also an expense of operations. The decline in value of a capital asset, such as a machine, because of use in operations or for other reasons, is called depreciation.

KINDS OF--Depreciation, or decline in value of capital assets, may be due to--

1. Physical causes, such as
   - (a) Wear and tear from use;
   - (b) Exposure to the elements, or the working of other "laws of nature"; or
   - (c) Accidental causes.

2. Functional causes, such as
   - (a) Obsolescence; or
   - (b) Inadequacy.

Another classification is (1) unit depreciation and (2) composite depreciation, the former referring to various capital asset units of the business, the latter to the depreciation of the entire capital asset investment of the business as a whole.

TREATMENT IN THE ACCOUNTS--

Depreciation of Machinery	$ 560.00	
To--Reserve for Depreciation of Machinery		$ 560.00
Provision for year on machine.		

Since depreciation is an expense of operations it is treated similar to any other expense: debited to the operations benefited; the coal consumed would be debited in the same way. The other half of the entry is rarely posted to the capital asset account, however, as it is desirable to keep the cost price distinct; in fact, the cost price of a capital asset is shown on the balance sheet from period to period, the depreciation being subtracted therefrom, until the capital asset has been disposed of. The reserve for depreciation is thus seen to be merely an offset, and nothing else, to an overstated asset.

Continuing the example of the machine and assuming the foregoing adjusting entry is made at the close of each of the five years of its life, a reserve of $2,800 will have accumulated. If, then, the old asset is discarded, having a scrap value of $200:

Reserve for Depreciation	$2,800.00	
Scrap Material	200.00	
To--Machinery Account		$3,000.00
Machine discarded.		

A new asset replacing the old will be debited to the capital asset account at its cost price in the usual way.

A PLANT LEDGER is kept by businesses having more than a few depreciating capital assets; it is commonly a card ledger, a card being devoted to each unit (machine or group of machines of the same character). The card is ruled in such a way that the depreciated value may be determined at any time, also the depreciation for the current period. (See illustrations in citations below.) Space is also provided for the recording of functional depreciation. The plant ledger may be divided into several sections such as buildings, machinery, fixtures, tools, etc., each having separate controlling accounts in the general ledger. Each section will be controlled by two accounts; thus the details of the machinery ledger are summarized (1) in the Machinery account and (2) in the Reserve for Depreciation on Machinery account.

METHODS OF PROVIDING FOR DEPRECIATION

Several methods of providing for depreciation are in use. These methods have arisen owing to the following facts: (1) the allowance for depreciation must be an estimate, inasmuch as the life of an asset cannot be definitely forecasted; (2) the factor of obsolescence or inadequacy constantly lessens the value of preceding estimates; (3) some machines require constantly increasing repairs as they age and it is found inequitable, in such cases, to equalize the cost of the asset over its life, especially when its productivity, as it declines in value, is greatly reduced.

1. <u>STRAIGHT-LINE METHOD</u>--This is the method in most common use, being the simplest in theory and application. In the above example of a machine whose life is five years, a yearly charge of $560 is required. This is computed according to the formula--

$$D = \frac{C - S}{n}$$

D representing the yearly charge to operations and yearly increase of depreciation reserve, C the cost of the asset, S its scrap or salvage value, and n the number of years the asset is expected to last.

2. <u>REDUCING BALANCE METHOD</u>--The reducing balance method applies under the theory that the expense of up-keep is light when an asset is new, and heavy in the final years of its life. The charges to operations on account of the asset are, by use of this method, more evenly distributed. It is also claimed that this method more accurately reflects on the books the large composite depreciation which takes place in the case of a new plant. The objection is that but few assets depreciate exactly in the manner indicated. In the following formula, P represents the percentage to be deducted each year from the declining values:

$$P = 1 - \sqrt[n]{\frac{S}{C}}$$

This formula, applied to the foregoing illustration, will produce results as follows:

	YEARLY PROVISION	TOTAL PROVISION	DEPRECIATED VALUE
Cost new	$--------	$--------	$3,000.00
First year	1,254.81	1,254.81	1,745.19
Second year	729.96	1,984.77	1,015.23
Third year	424.64	2,409.41	590.59
Fourth year	247.03	2,656.44	343.56
Fifth year	143.70	2,800.14	199.86
At end of fifth year	$2,800.14	$2,800.14	$ 199.86

The discrepancy of 14 cents is due to the fact that a six-place table of logarithms was used. The longer the life of the asset, the more nearly will the reducing balance method approach the straight-line method.

3. SINKING FUND METHOD--In this method an amount of money is set aside each year along with the regular provision for depreciation, the money being deposited outside the business and accumulating at compound interest. The amount to be charged against the expenses of the business will be the same each year, and will be computed according to the following formula:

$$D = (C - S)\frac{(r - 1)}{(rn - 1)}$$

r being the rate, which, if the interest to be allowed is 4%, will be stated as 1.04 for the purposes of this formula. Supposing the interest in our illustration is 4% compounded annually, the following table may be set up:

	CASH SET ASIDE YEARLY	COMPOUND INTEREST	YEARLY PROVISION	TOTAL CREDIT TO RESERVE	DEPRECIATED VALUE
Cost new	$--------	$------	$--------	$--------	$3,000.00
First year	516.96	------	516.96	516.96	2,483.04
Second year	516.96	20.68	516.96	537.64	1,945.40
Third year	516.96	42.18	516.96	559.14	1,386.26
Fourth year	516.96	64.55	516.96	581.51	804.75
Fifth year	516.94	87.81	516.94	604.75	200.00
Total	$2,584.78	$215.22	$2,584.78	$2,800.00	$ 200.00

The method as outlined is rarely used. It is considered better practice to retain the cash in the business and charge the interest element direct to operations.

Other methods used are described on the following page.

RESERVE FOR BAD DEBTS

Every business which caters to the general trade suffers losses from uncollectible accounts and notes. These losses are an expense of carrying on the business and are shown on a statement of profits and income as a selling or administrative expense, or, as advocated by a few writers, as a "financial" expense, i.e., deducted with such items as interest paid from net profits. At the end of each accounting period an estimate is made of the uncollectible accounts through any of the following methods:

1. A percentage of net sales
2. A percentage of outstanding accounts
3. An inspection of the accounts
4. Past experience

and an adjusting entry made as follows:

Bad Debts (an expense account)	$500.00	
To--Reserve for Bad Debts (a valuation account)		$500.00
To take up estimate of uncollectible accounts.		

The reserve serves to hold the expected loss temporarily until the worthless accounts can be found, since it is usually not possible to ascertain in advance just which accounts will prove to be worthless. An account, having proven bad, is written off as follows:

Reserve for Bad Debts	$ 75.00	
To--Customer's Account		$ 75.00
To write off uncollectible account.		

If the account is afterwards collected, the sum received is generally credited to the reserve.

Theoretically the loss from bad debts is composed of two elements: (1) the cost of the merchandise which the customer does not pay for, and (2) gross profit, with which, in addition to the cost of the merchandise, the customer has been charged. The loss of gross profit is not an operating expense, but income never received; however, the two elements are not distinguished in practice, the loss of gross profit being a relatively small figure.

RESERVE FOR DISCOUNTS

A reserve for discounts measures the overstatement of customers' accounts on account of cash discounts to be taken. It is created by a debit to Discounts on Sales account:

Discounts on Sales (an expense account)	$300.00	
To--Reserve for Discounts		$300.00
To provide for discounts expected to be taken.		

At the beginning of the following period the entry is reversed.

Both the reserve for bad debts and reserve discounts are valuation accounts and therefore are deducted on the balance sheet from the assets to which they apply.

REFERENCES:

Hatfield, pages 121-142
Leake, pages 67-135
Montgomery, pages 401-429
Saliers, pages 13-33, 39-48

COMPLETE ACCOUNTING COURSE--PART I

Lecture 22

SURPLUS

Problem 17

The H. K. Jerome Co. is a manufacturing corporation which has been in business for many years. On January 1, 1917, they commenced operations for the year 1917 in an entirely new plant, the financing of which was accomplished through the issue of ten notes of $20,000 each, interest at 6%, the notes maturing at the rate of one each year commencing with January 1, 1918. The old plant was disposed of for $10,000 in cash during December, 1916, and the balance sheet prepared at December 31, 1916, showed the following condition of the business:

ASSETS			LIABILITIES		
Plant	$225,000.00		Capital Stock		$200,000.00
Less Scrap Value realized	10,000.00	$215,000.00	Surplus		50,000.00
			Profit and Loss for 1916:		
			Net Sales	$100,000.00	
Current Assets		80,000.00	Less--Operating Expenses	75,000.00	25,000.00
			Floating Debt		20,000.00
Total Assets		$295,000.00	Total Liabilities		$295,000.00

The new plant was entered on the books at $200,000 on January 1, 1917, and is expected to have a life of 20 years (with a probable scrap value similar to the old plant). Owing to competition and limited demand for the products, the sales are not expected to increase, but the new and improved machinery, with better methods of manufacture, saves 10% in operating expenses according to the estimate of the manager.

At December 31, 1917, a second balance sheet was prepared:

ASSETS		LIABILITIES		
Plant	$415,000.00	Capital Stock		$200,000.00
Current Assets	112,500.00	Surplus		75,000.00
		Profit and Loss for 1917:		
		Net Sales	$100,000.00	
		Less--Operating Exp.	67,500.00	32,500.00
		Notes Payable		200,000.00
		Floating Debt		20,000.00
Total Assets	$527,500.00	Total Liabilities		$527,500.00

Interest on the notes payable has been included in the operating expenses of $67,500. The directors, having examined the balance sheet, decide to declare a dividend.

Discuss the foregoing and prepare a statement which, in your opinion, will more accurately display the financial position of the business on December 31, 1917.

WORK TO BE DONE IN THE PRACTICE SET

Record entries necessary to close the books on May 31, post same to general ledger, and prepare trial balance.

Solution to Assignment I-21-1

ADJUSTING JOURNAL ENTRIES NECESSARY BEFORE CLOSING BOOKS
OF MILLER MOTOR CAR CO., MAY 31

(1)

Interest Paid	$ 59.46	
To--Interest Accrued on Notes Payable		$ 59.46
Interest accrued during May on notes payable and bank loans as follows:		

$10,000.00	12 days @ 6%	$20.00
3,000.00	31 days @ 6%	15,50
10,000.00	12 days @ 5%	16.67
3,500.00	15 days @ 5%	7.29
		$59.46

(2)

Bond Interest	625.00	
To--Bond Interest Accrued		625.00
Interest accrued May 31 on bonds outstanding.		

(3)

Depreciation	916.66	
Depreciation on Fixtures	7.25	
Depreciation on Delivery Equipment	21.88	
To--Reserve for Depreciation of Buildings		83.33
Reserve for Depreciation of Machinery		833.33
Reserve for Depreciation of Fixtures		7.25
Reserve for Depreciation of Delivery Equipment		21.88
To set up reserves according to schedules.		

(4)

Bad Debts	916.97	
To--Reserve for Bad Debts		916.97
To provide reserve for bad debts at ½% of gross sales.		

(5)

Taxes	247.67	
To--Taxes Accrued		247.67
Additional taxes accrued during May.		

(6)

Insurance	$76.67	
To--Unexpired Insurance		$76.67
Insurance expired during May as per schedule.		

(7)

Miscellaneous Selling Expenses	50.00	
To--Rent Prepaid		50.00
Rent expired during May.		

(8)

Stationery and Printing	100.00	
To--Inventory of Miscellaneous Supplies		100.00
Supplies consumed during May.		

(9)

Inventory of Raw Materials	10,121.18	
To--Purchases Raw Materials		10,121.18
To transfer purchases.		

(10)

Work in Progress	8,754.78	
To--Inventory of Raw Materials		8,754.78
Total of requisitions issued during month.		

(11)

Inventory of Finished Parts	67,888.81	
To--Purchases Finished Parts		67,888.81
To transfer purchases.		

(12)

Work in Progress	55,101.55	
Cost of Sales--Finished Parts	14,953.18	
To--Inventory of Finished Parts		70,054.73
Finished Parts transferred to Work in Progress and Sold during month.		

(13)

Work in Progress	37,786.05	
To--Direct Labor		20,394.07
Indirect Labor		9,057.87
Heat, Light, and Power		2,591.85
Repairs--Plant and Equipment		3,478.53
Shop Supplies		843.75
Depreciation		916.66
Insurance		76.67
Taxes		247.67
Miscellaneous Factory Expenses		178.98
To close out cost of work in progress.		

(14)

Inventory Automobiles	$96,232.21	
To--Work in Progress		$96,232.21
To transfer cost of automobiles completed during month as per recapitulation of cost sheets.		

(15)

Cost of Sales--Automobiles	121,213.96	
To--Inventory of Automobiles		121,213.96
To transfer cost of automobile sales.		

Solution to Problem 16

(a)

ENTRIES ON FACTORY JOURNAL
TO CLOSE FACTORY LEDGER AT JUNE 30, 1917

(1)

Taxes	250.00	
Insurance	100.00	
To--General Ledger Account		$ 350.00
To take up accrued items as per entry in general journal.		

(2)

Work in Process	38,200.00	
To--Raw Materials		38,200.00
Total of requisitions issued for month, as per requisitions journal.		

(3)

Work in Process	11,450.00	
To--Factory Supplies		800.00
Direct Labor		8,550.00
Superintendence		650.00
Heat, Light, and Power		880.00
Taxes		250.00
Insurance		100.00
Miscellaneous Factory Expenses		220.00
To close out manufacturing cost, as per ledger accounts		

(4)

Finished Stock	48,500.00	
To--Work in Process		48,500.00
Stock completed during June as per finished stock journal.		

(5)

General Ledger	50,100.00	
To--Finished Stock		50,100.00
Cost of stock sold during month as per sales book and charged to customers in general ledger.		

ENTRIES ON GENERAL JOURNAL
TO CLOSE GENERAL LEDGER AT JUNE 30, 1917

		Debit	Credit
	(1)		
Office Salaries		$ 230.00	
To--Salaries Accrued			$ 230.00
Office salaries accrued and unpaid.			
	(2)		
Interest Expense		200.00	
To--Interest Prepaid			200.00
Prepaid interest expired.			
	(3)		
Trading Account		50,100.00	
To--Factory Ledger			50,100.00
To transfer cost of sales for month.			
	(4)		
Sales		56,000.00	
To--Trading Account			56,000.00
To transfer sales for month.			
	(5)		
Trading Account		5,900.00	
To--Profit and Loss			5,900.00
To close out gross profits for June.			
	(6)		
Profit and Loss		4,590.00	
To--Discount on Sales			100.00
Office Salaries			1,800.00
General Expense			800.00
Salesmen's Salaries and Expense			950.00
Sales Office Salaries and Expense			740.00
Interest Expense			200.00
To close out expense accounts.			
	(7)		
Discounts on Purchases		130.00	
Interest Received		650.00	
To--Profit and Loss			780.00
To close out miscellaneous income accounts.			
	(8)		
Profit and Loss		2,090.00	
To--Surplus			2,090.00
Net profits for June carried to Surplus.			

(b)

Exhibit A

INDEPENDENCE MANUFACTURING CO.
BALANCE SHEET, JUNE 30, 1917

ASSETS			CAPITAL & LIABILITIES		
CAPITAL ASSETS:			CAPITAL STOCK:		
Real Estate	$15,000		Issued and Outstanding		$75,000
Buildings & Equip.	55,000	$70,000	CURRENT LIABILITIES:		
			Bank Loans	$10,000	
WORKING ASSETS:			Accounts Payable	15,800	
Fuel Supplies	$ 400		Salaries Unpaid	230	
Prepaid Interest	100		Taxes Accrued	1,400	27,430
Unexpired Insurance	580	1,080			
			Notes Receivable		
CURRENT ASSETS:			Discounted $5,000		
Inventories of--					
Finished Goods	$ 4,200		SURPLUS:		
Work in Process	5,250		Balance, May 31,		
Raw Materials	2,200		1917	$42,310	
Notes Receivable	1,500		Profits for June		
Accounts Receivable	44,500		(Exhibit B)	2,090	44,400
Cash	18,100	75,750			
		$146,830			$146,830

(c)

Exhibit B

INDEPENDENCE MANUFACTURING CO.
STATEMENT OF PROFITS AND INCOME
MONTH ENDING JUNE 30, 1917

SALES			$56,000.00
COST OF SALES (Exhibit C)			50,100.00
GROSS PROFIT ON SALES			$ 5,900.00
DEDUCT--SELLING AND GENERAL EXPENSES:			
Selling Expenses:			
Salesmen's Salaries and Expense	$950.00		
Sales Office Salaries and Expense	740.00	$1,690.00	
General Expenses:			
Office Salaries	$1,800.00		
General Expense	800.00	2,600.00	4,290.00
NET PROFIT FROM OPERATIONS			$1,610.00
ADD--MISCELLANEOUS INCOME:			
Discounts on Purchases		$130.00	
Interest Received		650.00	780.00
			$ 2,390.00
DEDUCT--INTEREST CHARGES:			
Interest Expense			300.00
SURPLUS NET PROFITS (Exhibit A)			$ 2,090.00

Exhibit C

(d)

INDEPENDENCE MANUFACTURING CO.
STATEMENT OF COST OF MANUFACTURE AND OF SALES
MONTH ENDING JUNE 30, 1917

MATERIALS		$38,200.00
DIRECT LABOR		8,550.00
FACTORY OVERHEAD:		
Supplies	$800.00	
Superintendence	650.00	
Heat, Light, and Power	880.00	
Taxes	250.00	
Insurance	100.00	
Miscellaneous Expense	220.00	2,900.00
TOTAL MANUFACTURING COST		$49,650.00
DEDUCT--Increase in Inventory of Work in Process--		
May 31, 1917	$4,100.00	
June 30, 1917	5,250.00	1,150.00
COST OF GOODS COMPLETED		$48,500.00
ADD--Decrease in Inventory of Finished Stock--		
May 31, 1917	$5,800.00	
June 30, 1917	4,200.00	1,600.00
COST OF FINISHED STOCK SOLD (Exhibit B)		$50,100.00

SURPLUS

DEFINITION--Surplus is the excess of the total assets over the total liabilities and capital stock of a corporation. Normally it represents the amount of realized profits which has not been appropriated for specific purposes, and therefore is available for dividends. In some companies, notably banks, a distinction is drawn between "Surplus" and "Undivided Profits," the former referring to that part which has been set aside permanently, and the latter to that part which is available for dividends. Adding capital stock to surplus gives "Net Worth" or "Book Value" of the business.

PROFIT AND LOSS ACCOUNT--In a sole proprietorship or partnership the balance of the Profit and Loss account is carried to the proprietors' accounts, while in a corporation the balance is carried to Undivided Profits account or Surplus account. Public utilities under jurisdiction of the Interstate Commerce Commission are required to keep a Profit and Loss account which is equivalent to a Surplus account as the latter term is used by mercantile and industrial businesses.

UNDIVIDED PROFITS ACCOUNT--As stated, the balance of the Profit and Loss account is sometimes carried to an Undivided Profits ledger account. Part of the undivided profits may be paid out in dividends, part may be transferred to Surplus ledger account, and part may remain in the Undivided Profits ledger account.

APPROPRIATED SURPLUS--This term is applied to reserves for contingencies, sinking fund reserves, etc., which are part of the net worth or book value of the corporation, but which, for the time being, are set aside for special purposes by formal action of the board of directors.

FREE SURPLUS--This term is equivalent to undivided profits, and refers to the portion of surplus available for dividends.

CAPITAL SURPLUS--This applies to that part of surplus which has not been earned through operations. It is distinct from ordinary surplus and should be shown separately on the balance sheet. Capital surplus may arise from the following sources:

1. CONTRIBUTIONS FROM STOCKHOLDERS:

(a) Premiums on Sale of Capital Stock. Thus, if 1,000 shares, par value $100, are disposed of at 125, $25,000 of the receipts should be credited to Capital Surplus or to a similar account. The premium paid is not an earning. In the case of a new corporation the excess may represent an amount contributed for working capital purposes, and is therefore as much a part of the capital investment as the par value of $100,000; or if contributed to pay promoters' expenses, expenses of incorporation, etc., the excess will be so applied. In the case of an established corporation, a premium given on sale of additional securities usually means that the earnings have influenced the sale price figure of the new stock.

(b) Donations of Capital Stock. The type of financing illustrated by this procedure is common in the case of mines, oil wells, etc., where the asset purchased with the stock is a wasting asset. The vendor conveys the property for a specified amount of capital stock and with the understanding that a specified amount of the stock received is to be donated to the company, and from the sale thereof funds will be obtained for working capital.

(c) Assessments on Stock. The term "assessments" refers to a "call" on stock not fully paid up (usually after a period of operation), or to a levy on fully paid-up stockholders to enable the corporation to continue operations. In the latter case the assessment is credited to Capital Surplus.

(d) Undercapitalization. Illustration has already been given of a new corporation taking over the net assets of a business, the value of which exceeded the par value of the stock. This is, in effect, a premium on the issue, provided the assets taken over are not overvalued.

2. BOOK ENTRIES. Increases in the value of land or other capital asset, if it is desirable to put such increase on the books, should be credited to Capital Surplus account, and taken out of Capital Surplus and transferred to ordinary surplus in case the asset is sold and the profit realized.

REFERENCES:
Bennett, pages 334-337
Montgomery, pages 199-200, 206
Esquerre, pages 357-359

COMPLETE ACCOUNTING COURSE--PART I

Lecture 23

DIVIDENDS

Problem 18

The Vanadium Manufacturing Co. is a New York corporation; its common stock has been issued "without par value." The preferred stock has a par value of $100 per share and is cumulative, non-participating, and non-voting. At the annual meeting of the board of directors on December 20, 1917, a dividend of 7% is declared on the preferred stock and $3 per share on the common, payable January 15, 1918, to stockholders of record January 1, 1918. The following is a trial balance of the general ledger December 31, 1917:

Real Estate	$ 30,000.00	
Buildings	50,000.00	
Machinery and Equipment	175,000.00	
Good-will	50,000.00	
Inventory of Finished and Partly Finished Goods, January 1, 1917	21,000.00	
Inventory of Raw Materials, January 1, 1917	17,000.00	
Accounts Receivable	8,000.00	
Cash in Bank	14,000.00	
Petty Cash Fund	500.00	
Preferred Stock (1,200 shares)		$120,000.00
Common Stock (2,500 shares)		125,110.00
Surplus, January 1, 1917		23,190.00
Accounts Payable		24,000.00
Accrued Taxes		2,200.00
Reserve for Depreciation of Buildings		10,000.00
Reserve for Depreciation of Machinery and Equipment		35,000.00
Sales		450,000.00
Purchases Raw Materials	245,000.00	
Direct Labor	75,000.00	
Heat, Light and Power	11,000.00	
Superintendence	10,000.00	
Maintenance and Repairs	5,000.00	
Taxes	2,200.00	
Miscellaneous Factory Expense	5,800.00	
Officers' Salaries	25,000.00	
Office Salaries	10,000.00	
General Expense	9,000.00	
Salesmen's Salaries and Commissions	15,000.00	
Salesmen's Expenses	3,000.00	
Advertising	6,000.00	
Sales Discounts	2,000.00	
	$789,500.00	$789,500.00

Inventories on December 31, 1917, were composed of: finished and partly finished goods $25,000; raw materials $15,000. Accrued taxes not on books $200. Yearly provision for depreciation, 3% on buildings, 10% on machinery and equipment (straight-line method); provision for 1917 does not yet appear on books. The dividends declared have not yet been recorded.

Prepare statements to show financial condition on December 31, 1917, and results from operation during year ending that date.

WORK TO BE DONE IN THE PRACTICE SET

Prepare balance sheet at May 31, and statement of profits and income for month of May.

Solution to Assignment I-22-2

MILLER MOTOR CAR CO.
TRIAL BALANCE, MAY 31, 19--

ACCOUNT	DEBIT	CREDIT
Land	$ 25,000.00	
Buildings	50,000.00	
Reserve for Depreciation of Buildings		$ 83.33
Machinery, Tools, and Equipment	105,603.50	
Reserve for Depreciation of Machinery		833.33
Office and Warehouse Fixtures	1,450.00	
Reserve for Depreciation of Fixtures		7.25
Delivery Equipment	1,750.00	
Reserve for Depreciation of Delivery Equipment		21.88
Good-will	66,000.00	
Subscriptions--Common Stock	10,000.00	
Inventory of Automobiles, May 31	8,218.25	
Inventory of Work in Progress, May 31	5,410.17	
Inventory of Raw Materials, May 31	1,366.40	
Inventory of Finished Parts, May 31	3,724.08	
Inventory of Miscellaneous Supplies	200.00	
Customers' Accounts	117,889.61	
Notes Receivable	48,025.00	
Reserve for Bad Debts		916.97
Cash in Bank	9,082.62	
Petty Cash Fund	500.00	
Unexpired Insurance	843.33	
Rent Paid in Advance	150.00	
Capital Stock--Preferred		100,000.00
Capital Stock--Common		100,000.00
5% First Mortgage Bonds		150,000.00
Notes Payable		3,500.00
Bank Loan		13,000.00
Audited Vouchers		70,885.14
Accrued Interest on Notes Payable		45.46
Accrued Bond Interest		625.00
Accrued Taxes		447.67
Accrued Pay-roll		7,581.91
Sales--Automobiles		164,065.00
Sales--Finished Parts		19,329.75

Discount on Sales--Finished Parts	914.60	
Cost of Sales--Automobiles	121,213.96	
Cost of Sales--Finished Parts	14,953.18	
Discount on Purchases		1,093.97
Interest Received		150.00
Consignment Earnings		300.00
Salesmen's Salaries	3,358.95	
Salesmen's Traveling Expenses	475.81	
Advertising	31,882.29	
Freight-Out	103.50	
Delivery Equipment Maintenance	10.48	
Depreciation of Delivery Equipment	21.88	
Miscellaneous Selling Expenses	50.00	
Depreciation of Office and Warehouse Fixtures	7.25	
Office Salaries	628.95	
Salaries of Officers	1,800.00	
Stationery and Printing	590.80	
Bad Debts	916.97	
Miscellaneous General Expense	60.62	
Bond Interest	625.00	
Other Interest Paid	59.46	
	$632,886.66	$632,886.66

SCHEDULE OF UNPAID VOUCHERS

VOUCHER NO.	FAVOR OF	AMOUNT
23	Specialties Mfg. Co.	$ 1,202.85
33	Auto. Accessories Mfg. Co.	6,785.03
34	Specialties Mfg. Co.	2,882.50
35	New Idea Lamp Co.	811.19
40	B. F. Goodrich Co.	910.17
41	Auto. Accessories Mfg. Co.	312.37
42	Standard Wheel Co.	1,933.25
44	Western Printing Co.	626.84
45	Best Drop Forge Works	1,932.94
46	Briscoe Radiator Co.	2,750.00
47	U. S. Advertising Company	30,738.00
48	Crown Automobile Company	20,000.00
	Total	$70,885.14

SCHEDULE OF CUSTOMERS' ACCOUNTS

DISTRICT	AMOUNT
#1	$48,203.58
2	9,945.35
3	9,682.20
4	28,972.03
5	7,519.46
7	9,100.68
8	4,466.31
Total	$117,889.61

DIVIDENDS

DEFINITION--A dividend is a portion of profits or surplus of a corporation set aside by action of the board of directors for distribution among stockholders. The distribution may consist of the transferring of whatever property or property rights the directors may desire to distribute.

KINDS OF--The nature of the various kinds of dividends is indicated by their titles:

1. CASH DIVIDEND--a distribution of cash. Unless otherwise qualified the term "dividend" refers to a cash dividend.
2. STOCK DIVIDEND--a distribution of treasury stock or unissued stock.
3. SCRIP DIVIDEND--a distribution of "scrip," i.e., promissory notes, usually interest-bearing. This kind of dividend is sometimes declared by railroads and other corporations for the purpose of retaining in the business the funds with which the scrip must be finally liquidated.
4. PROPERTY DIVIDEND--a distribution of some kind of property, other than cash. A large munitions manufacturer in 1916 declared such a dividend payable in Anglo-French bonds.

The term "dividend" is also applied to other distributions of property, such as bonuses to employees under profit-sharing schemes, etc., and distributions of property to stockholders when a corporation winds up its affairs.

DECLARATION--A dividend is "declared" by resolution of the directors, and until such resolution is passed the books of the corporation reflect no liability, even to cumulative preferred shareholders, on account of proposed dividends. The directors have sole authority to dispose of corporate profits and no action on the part of stockholders can force them to pay out dividends, unless, of course, some fraudulent intent can be shown. Once declared, the amount of the dividend becomes a liability of the corporation enforcible by the stockholders through legal action.

The declaration and payment may be made on the same date. This is possible only in a small corporation. In a larger business there are usually three important dates in connection with each dividend declared:

1. Date of declaration.
2. Date stock records are closed. The time elapsing from (1) to (2) is utilized by purchasers of stock (on the open market for instance) by having their ownership properly inscribed on the stock ledger of the corporation. Thereafter dividends are payable only to "stockholders of record" on the day the stock ledger is closed. Stock sold between (2) and (3) is sold "ex-dividend"--the right to the dividend declared being retained by the seller.
3. Date of payment.

These dates are indicated in the resolution authorizing the dividend.

PROFITS AVAILABLE FOR DISTRIBUTION--Directors have a wide discretion in declaring dividends. They may declare a dividend up to the total net profits available for distribution. If a portion of the profits of prior years has not been distributed in dividends but has been allowed to accumulate in the Surplus account, a dividend may be declared out of such accumulated surplus, even though the operations of the current period have resulted in profits of an amount less than the dividend or even a loss. The amount of a dividend is otherwise always a matter of policy which is based on a consideration of many points. It has been generally held that dividends cannot be paid "from capital," i.e., where the result of the payment is to create or add to an already existing deficit. However, dividends paid by a mining corporation may include a return of both profits and capital invested.

Courts have held that dividends may be paid from surplus arising from sources other than operations, such as increase in property values, donations of stockholders, etc., although as a matter of business policy such dividends might be objectionable, especially if paid in cash.

PAYMENT--In a small corporation payment of cash dividends may be made to stockholders in currency or by check, the stockholder signing a receipt. With larger corporations it is the practice to deposit the required amount in a separate bank account and to draw checks against it.

ENTRIES--When a dividend is declared, an entry similar to the following is necessary:

-January 5, 1917-		
Dividends (a nominal account to be carried to Surplus)	$20,000.00	
To--Dividends Payable		$20,000.00
To record dividend of 10% declared on common stock by resolution of the Board of Directors at their annual meeting held today, payable March 1 to stockholders of record February 1.		

And when paid:

-March 1, 1917-		
Dividends Payable	$20,000.00	
To--Cash (Unissued or Treasury Stock, etc.)		$20,000.00
To record payment of dividend declared January 5.		

Dividends may be numbered consecutively, for various purposes.

REFERENCES:
- Bennett, pages 133-155
- Gilman, pages 321-328
- Hatfield, pages 214-231

COMPLETE ACCOUNTING COURSE--PART I

Lecture 24

REDEMPTION OF BONDS

Problem 19

A bond issue of the X Y Co. is dated April 1, 1909, and consists of 500 bonds having a par value of $1,000 each, running 50 years and bearing interest at 5%. Under the title of "Sinking Fund Assets" the following details appear on the balance sheet prepared December 31, 1916:

Bonds of X Y Co.	$50,000.00
Bonds of A B Co.	15,000.00
Cash	10,100.00
Total	$75,100.00

On June 30, 1917, the trustee holding the sinking fund assets renders the following report for the six months ended that date:

Dec 31, 1916	Cash balance		$10,100.00
RECEIPTS			
April 1, 1917	Instalment #8 received	$10,000.00	
April 1, 1917	Coupons on Bonds of X Y Co. ($50,000 @ 5%, due Apr. 1 and Oct. 1)	1,250.00	
May 1, 1917	Coupons on Bonds of A B Co. ($15,000 @ 6%, due May 1 and Nov. 1)	450.00	
May 1, 1917	Sale of Bonds of A B Co at 104	15,600.00	
June 30, 1917	Interest on Cash Balance	240.00	27,540.00
			$37,640.00
PAYMENTS			
May 1, 1917	Purchase of Bonds of X Y Co. (36 at par and accrued interest)	$36,150.00	
May 1, 1917	Commission on Sale and Purchase of bonds	250.00	
June 30, 1917	Expenses of Trustee (clerical help, stationery, etc.) for six months ending June 30, 1917	50.00	36,450.00
June 30, 1917	Cash Balance		$1,190.00

Give journal entries necessary on the books of the X Y Co. relative to the sinking fund from December 31, 1916, to June 30, 1917, and indicate how the account would be shown in the balance sheet prepared at June 30, 1917.

MISCELLANEOUS QUESTIONS

<u>Question 74</u>--What differences would you expect to find in the accounting procedure (a) where the sinking fund assets are turned over to the trustee under the indenture, or (b) where the assets are retained in the corporation's treasury?

<u>Question 75</u>--"The company under its trust deed is required to set aside a certain percentage of its profits at the close of each year to provide a sinking fund for retiring its bonded indebtedness when it matures."

Explain briefly what is meant by the above quotation, indicating to a bondholder not familiar with accounting theory how his interests are protected.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

JUNE 1

The management decides to change the payment of wages and salaries from a weekly to a semimonthly basis. In accordance therewith the pay-roll accrued at May 31 is paid. Pay invoices of Specialties Manufacturing Co. $1,202.85 and $2,882.50. Pay Best Drop Forge Works their invoice of May 25, deducting the discount. The board of directors declare a 1.75% cash dividend on the preferred stock, and 1% cash dividend on the common stock, payable June 5 to stockholders of record June 1.

June 2

To enable the production department to keep pace with the sales and to insure prompt deliveries, the board of directors authorizes the purchase of the Best Automobile Co.'s plant. The balance sheet submitted by them is as follows:

BEST AUTOMOBILE CO.
BALANCE SHEET, MAY 31, 1917

ASSETS		LIABILITIES	
Land	$15,000.00	Capital Stock	$100,000.00
Buildings	20,000.00	First Mortgage 6% Bonds	75,000.00
Machinery	60,000.00	Notes Payable	67,000.00
Good-will	75,000.00	Accounts Payable	57,985.00
Inventories:		Bond Interest Accrued	3,000.00
Raw Material	4,504.00	Taxes Accrued	1,562.00
Work in Progress	26,300.00	Pay-roll Accrued	11,542.00
Finished Parts	19,050.00	Surplus	55,650.00
Automobiles	55,150.00		
Customers' Accounts	60,285.00		
Notes Receivable	35,000.00		
Cash	1,450.00		
	$371,739.00		$371,739.00

After due consideration the Miller Motor Car Co. offers to purchase all the assets except good-will, customers' accounts, notes receivable, and cash, at the valuations given in the balance sheet and to assume all the liabilities except notes payable and accounts payable. $25,000 is to be paid in cash on the date of sale, the balance in common stock. To complete the purchase the stockholders authorize an increase in the common stock to $500,000, and 839 shares are issued at once to the Best Automobile Co. and recorded as fully paid.

Discount at City National Bank our 30-day note for $40,000 at 6%. Pay Standard Wheel Co., and B. F. Goodrich Co., invoices of May 23. Pay the accrued pay-roll of the Best Automobile Co.

JUNE 4

District managers' reports show sales of $24,758.22 divided as follows: automobiles $18,575; accessories $6,183.22. Bank allowed $5.04 interest on May cash balances.

JUNE 5

Collection report: cash $38,753.28; discount allowed $498.28; notes received $30,000. Purchase additional furniture from Chicago Furniture Co. $595.00, net 30 days.

Issue checks to treasurer for the preferred stock dividend of $1,750, and the common stock dividend of $1,000. Pay Automobile Accessories Manufacturing Co. invoice of May 18 amounting to $6,923.50, deducting 2% discount.

JUNE 6

Sell 100 shares of common stock at par. Receive from notes receivable $16,500, and accrued interest thereon $28.78. Receive the following shipments today:

Specialties Mfg. Co., Finished Parts	$6,875.50	terms July 1					
Stahl Steel Works, Raw Material	2,933.74	"	1% 10 days,	net	30 days		
Best Drop Forge Works, Raw Material	3,387.50	"	2½% 5	"	"	30	"
B. F. Goodrich Co., Finished Parts	9,875.00	"	2% 10	"	"	30	"
Washed Coal Co., Heat, Light, and Power	2,575.28	"	2% 10	"	"	60	"

JUNE 7

Automobile Accessories Manufacturing Co. refused to allow the discount of $138.47, which we deducted from their invoice dated May 18. Send them check for same. Also send them check in payment of their invoice of the 23rd. Pay our demand notes in favor of the First National Bank for $3,000 and $10,000, with accrued interest thereon amounting to $51.39.

JUNE 8

The voucher in favor of Stahl Steel Works for invoice of $2,933.74 entered June 6 is incorrect. Same should be $2,393.74. (Cancel and issue a new one.) Issue check favor cash for $2,000 to be advanced to various salesmen on account of traveling expenses.

JUNE 9

Six cars are returned by customers as defective. (Return sales book.) The sale price thereof was $14,875. Pay freight bills of Penn. R. R. Co. $409.97, of which $129.72 is chargeable to Finished Parts and $280.25 to Raw Material.

JUNE 11

Sales managers' reports show automobile sales of $63,250, and sales of accessories amounting to $11,698.23. Pay Best Drop Forge Works invoice of June 6.

JUNE 12

Sundry parts sold prove to be unsatisfactory. Returns amounted to $475.27. Collection report: cash $31,322.98; discounts allowed $523.27; notes received $32,875.

JUNE 13

Received shipment of finished parts from Western Motor Castings Co. with 10-day sight draft for $6,543.50 attached to bill of lading. Accept the draft.

JUNE 14

District managers' reports show that $2,075.28 has been allowed to customers, $1,854.00 on automobiles and $221.28 on accessories. Fred Miller purchases a car at $3,500 to be charged to his personal account. (Sales book.)

JUNE 15

Returned to Best Drop Forge Works defective forgings (raw material) amounting to $460.50, less 2½% discount which was deducted on payment of invoice. Receive on account of notes receivable $17,575 and $87.28 accrued interest.

Solution to Assignment I-23-2

Exhibit A

MILLER MOTOR CAR CO
BALANCE SHEET, MAY 31, 19--

ASSETS

CAPITAL ASSETS:	Cost	Reserve for Depreciation	Present Value	
Land	$ 25,000.00	$------	$ 25,000.00	
Buildings	50,000.00	83.33	49,916.67	
Machinery, Tools, and Equipment	105,603.50	833.33	104,770.17	
Office and Warehouse Fixtures	1,450.00	7.25	1,442.75	
Delivery Equipment	1,750.00	21.88	1,728.12	
	$183,803.50	$945.79	$182,857.71	
Good-will			66,000.00	$248,857.71
SUBSCRIPTIONS TO CAPITAL STOCK				10,000.00
CURRENT ASSETS:				
Inventories:				
Automobiles		$ 8,218.25		
Work in Progress		5,410.17		
Raw Materials		1,366.40		
Finished Parts		3,724.08		
Miscellaneous Supplies		200.00	$ 18,918.90	
Customers' Accounts		$117,889.61		
Notes Receivable		48,025.00		
		$165,914.61		
Less--Reserve for Bad Debts		916.97	164,997.64	
Cash in Bank		$ 9,082.62		
Petty Cash Fund		500.00	9,582.62	193,499.16
DEFERRED CHARGES:				
Unexpired Insurance			$ 843.33	
Rent Paid in Advance			150.00	993.33
				$453,350.20

LIABILITIES

CAPITAL STOCK:			
7% Preferred Stock		$100,000.00	
Common Stock		100,000.00	$200,000.00
5% FIRST MORTGAGE BONDS			150,000.00
CURRENT LIABILITIES:			
Notes Payable		$ 3,500.00	
Bank Loan		13,000.00	
Audited Vouchers		70,885.14	
Accrued Liabilities:			
Interest on Notes Payable	$ 45.46		
Bond Interest	625.00		
Taxes	447.67		
Pay-roll	7,581.91	8,700.04	96,085.18
SURPLUS:			7,265.02
Profit for May (Exhibit B)			
			$453,350.20

MILLER MOTOR CAR CO.
STATEMENT OF PROFITS AND INCOME
MONTH ENDING MAY 31, 19--

Exhibit B

	AUTOS	FINISHED PARTS	TOGETHER
SALES	$164,065.00	$19,329.75	$183,394.75
Deduct--Discount on Sales	----------	914.60	914.60
NET SALES	$164,065.00	$18,415.15	$182,480.15
DEDUCT--Cost of Sales, Exhibits C and D	121,213.96	14,953.18	136,167.14
GROSS PROFIT ON SALES	$ 42,851.04	$ 3,461.97	$ 46,313.01
DEDUCT--SELLING AND GENERAL EXPENSES:			
Selling Expenses (Exhibit E)		$35,902.91	
General and Administrative Expenses (Exhibit F)		4,004.59	39,907.50
NET PROFITS FROM OPERATION			$ 6,405.51
ADD--MISCELLANEOUS INCOME:			
Discount on Purchases		$ 1,093.97	
Interest Received		150.00	
Consignment Earnings		300.00	1,543.97
			$ 7,949.48
DEDUCT--INTEREST CHARGES:			
Bond Interest		$ 625.00	
Other Interest Paid		59.46	684.46
SURPLUS NET PROFITS (carried to Exhibit A)			$ 7,265.02

Exhibit C

MILLER MOTOR CAR CO.
COST OF AUTO SALES
MONTH ENDING MAY 31, 19--

MATERIALS:			
Raw Materials:			
Purchases	$10,121.18		
Less--Inventory, May 31	1,366.40	$ 8,754.78	
Finished Parts		55,101.55	$63,856.33
DIRECT LABOR			20,394.07
FACTORY EXPENSE:			
Indirect Labor		$ 9,057.87	
Heat, Light, and Power		2,591.85	
Repairs, Plant, and Equipment		3,478.53	
Shop Supplies		843.75	
Depreciation		916.66	
Insurance		76.67	
Taxes		247.67	
Miscellaneous Factory Expenses		178.98	17,391.98
TOTAL MANUFACTURING COST			$101,642.38
DEDUCT--Inventory Work in Progress, May 31			5,410.17
COST OF AUTOMOBILES MANUFACTURED			$96,232.21
ADD--Decrease in Inventory of Automobiles:			
Inventory, May 1 (including Consignment Returned)		$33,200.00	
Inventory, May 31		8,218.25	24,981.75
COST OF AUTOMOBILES SOLD (carried to Exhibit A)			$121,213.96

Exhibit D

MILLER MOTOR CAR CO.
COST OF FINISHED PARTS SALES
MONTH ENDING MAY 31, 19--

INVENTORY OF FINISHED PARTS, May 1		$ 5,890.00
PURCHASES		67,888.81
		$73,778.81
Less--Finished Parts used in Production	$55,101.55	
Inventory, May 31	3,724.08	58,825.63
COST OF FINISHED PARTS SOLD (carried to Exhibit B)		$14,953.18

Exhibit E

MILLER MOTOR CAR CO.
SELLING EXPENSES
MONTH ENDING MAY 31, 19--

Salesmen's Salaries	$ 3,358.95
Salesmen's Traveling Expenses	475.81
Advertising	31,882.29
Freight-Out	103.50
Delivery Equipment Maintenance	10.48
Depreciation of Delivery Equipment	21.88
Miscellaneous Selling Expenses	50.00
Total (carried to Exhibit B)	$35,902.91

Exhibit F

MILLER MOTOR CAR CO.
GENERAL AND ADMINISTRATIVE EXPENSES
MONTH ENDING MAY 31, 19--

Salaries of Officers	$ 1,800.00
Office Salaries	628.95
Depreciation of Office and Warehouse Fixtures	7.25
Stationery and Printing	590.80
Bad Debts	916.97
Miscellaneous General Expense	60.62
Total (carried to Exhibit B)	$ 4,004.59

Solution to Problem 17

H. K. JEROME CO.
ADJUSTED BALANCE SHEET, DECEMBER 31, 1917

ASSETS

PLANT			$200,000.00
DEDUCT--Reserve for Depreciation			9,500.00
			$190,500.00
CURRENT ASSETS			112,500.00
			$303,000.00

LIABILITIES AND NET WORTH

NOTES PAYABLE ($20,000.00 Payable Jan. 1, 1918)			$200,000.00
CURRENT LIABILITIES:			
Floating Debt			20,000.00
TOTAL LIABILITIES			$220,000.00
NET WORTH:			
Capital Stock Issued and Outstanding		$200,000.00	
Deduct--Deficiency:			
Surplus as per books Jan. 1, 1917	$75,000.00		
Deduct--Net Loss incident to abandonment of old plant representing accrued depreciation not provided for	215,000.00		
Balance, as adjusted	$140,000.00		
Surplus Net Profits for year ending December 31, 1917	23,000.00	117,000.00	83,000.00
			$303,000.00

It appears that up to within the last few years the business has not been very profitable and some part of the dividends paid, assuming that dividends were paid, has been out of capital. If no dividends have been paid, the deficiency is represented in actual losses sustained from operation.

Provision for accrued depreciation of the new plant for the first year of its existence has been made in the adjusted accounts.

REDEMPTION OF BONDS

MANNER OF REDEMPTION--The manner in which a particular bond issue may be redeemed is outlined in the trust deed. Some of the methods used are:

1. Redemption through payment of cash at maturity. It is usual in this case to create a sinking fund for the purpose, as described below.

2. Drawing by lot of bonds to be retired at various periods set forth in the trust deed. In this case a sinking fund may or may not be used.

3. Redemption by serial payments. Bonds here bear the title of "serial bonds" and are redeemable at the dates specified on their face.

4. Refunding. New bonds are exchanged for old, being given to old bondholders, or new bonds are issued and sold and proceeds used for redemption of old bonds.

5. Conversion. Bonds may be designated "convertible bonds," in which case, at the option of the holder, they may be converted into some other security of the corporation, usually stock.

DISTINCTION BETWEEN SINKING FUND AND SINKING FUND RESERVE--The term FUND should be applied ONLY to assets, but often refers, especially when used in connection with "sinking fund," to both a debit and credit which appear on the balance sheet. In the following discussion, "sinking fund" will refer to the asset, while "sinking fund reserve" will refer to the credit.

A SINKING FUND is a sum of money set aside, usually periodically and drawing interest, for the purpose of meeting a future obligation.

A SINKING FUND RESERVE is an appropriation of profits or surplus maintained until the obligation, to which it refers, has been met, after which it is returned to Surplus or otherwise disposed of.

SINKING FUND--It is evident that the creation of either a sinking fund or a sinking fund reserve serves to protect the interests of the bondholders. Some trust deeds require the creation of a fund, others the creation of a reserve and in some cases the creation of both.

The trust deed often provides that a certain sum of money shall be turned over to the trustee at regular intervals and shall be invested by him according to the terms of the agreement. The date of the first instalment may be some time after the issue of the security in order that the corporation may first get on its feet. Or an amount may be paid the trustee based on annual production.

For example, twenty-year bonds are issued January 1, 1915, to the amount of $1,000,000, the trust deed calling for the payment by the corporation to the trustee, of equal annual instalments, the total of which, together with 4% compound interest allowed by the trustee, will amount to the sum required for redemption January 1, 1935, which will be at par. By the use of a bond table (see Sprague, "Accountancy of Investment," page 354) the amount invested yearly for twenty years which will amount to $1 at 4% interest is $.03358175. The amount necessary to turn over to the sinking fund trustee in the illustration cited will therefore be $33,581.75.

-December 31, 1915-

Sinking Fund Trustee	$33,581.75	
To--Cash		$33,581.75
To record payment of Instalment #1 to trustee. See Section 4 of trust deed.		

A similar entry is made the following year:

-December 31, 1916-

Sinking Fund Trustee	$33,581.75	
To--Cash		$33,581.75
To record payment of Instalment #2 to trustee, according to the provisions of the trust deed, Section 4.		

On December 31, 1916, however, interest will have accrued on the instalment of the previous year, requiring the following entry:

-December 31, 1916-

Sinking Fund Trustee	$ 1,343.27	
To--Income from Sinking Fund		$ 1,343.27
Interest at 4% on instalment paid December 31, 1915.		

The income from the sinking fund will be added to the current profits for the year and carried to Surplus, unless a sinking fund reserve is also maintained, in which case the income may be credited to the reserve, as described below.

If the trustee is allowed or required to use the funds in his possession to purchase portions of the outstanding issue for which the fund has been created, upon his report to the corporation of such purchase, the following entry would be made:

-July 5, 1917-

Bonds Held by Sinking Fund Trustee	$20,000.00	
To--Sinking Fund Trustee		$20,000.00
To record purchase of 20 bonds by trustee at par, as detailed in his report dated July 1, 1917.		

In case bonds are repurchased by the trustee, the corporation may or may not be required by the trust deed to pay over to the trustee the interest accruing on the bonds held by him. In either case the net effect on the corporation's books would be the same since credit would be taken at the end of the year, as illustrated above, for all increment from the funds in the hands of the trustee.

If the bonds, when repurchased by the trustee are CANCELLED, an entry should be made to record the fact properly:

-July 5, 1917-

Bonds Outstanding	$20,000.00	
To--Bonds Held by Sinking Fund Trustee		$20,000.00
To record cancellation of 20 bonds acquired by trustee.		

If the bonds are held alive in the sinking fund and will be sold again by the trustee they may be carried as an asset on the balance sheet, for the same reason that treasury stock may be carried as an asset. But if they are not to be resold, the better practice would seem to be to deduct them from the authorized issue, properly qualifying the deduction, however, by stating they are in the hands of the trustee. The purchase of bonds by the trustee may affect the annual instalment and interest.

When the bonds are finally redeemed, if we suppose none were cancelled in the meantime, the following entry is necessary:

Bonds Outstanding	$1,000,000.00	
To--Sinking Fund Trustee		$ 400,000.00
Bonds Held by Sinking Fund Trustee		600,000.00
To record redemption of bonds by payment of cash to bondholders by trustee and the surrender and cancellation of the entire issue. (It is supposed that the trustee at the time of redemption has acquired 6,000 bonds of the issue.)		

SINKING FUND RESERVE--Many trust deeds require that the sinking fund instalment shall be a charge "against earnings," the purpose being to prevent the distribution of dividends from the yearly profits before the sinking fund has been provided for. Nevertheless, the periodical instalment is an APPROPRIATION OF PROFITS, NOT AN EXPENSE, and on the balance sheet the reserve is often shown under the title of "Appropriated Surplus."

The creation of a sinking fund reserve alone will not act as a guarantee to bondholders that funds will be available to redeem their holdings at maturity. Unless an equivalent amount of cash has been set aside at the same time, the corporation may be financially embarrassed when the date of redemption arrives, for the reason that the funds represented by the reserve, arising out of profits, may have been invested in capital assets or in forms of working capital other than cash and not readily convertible into cash. Hence, the provision for the reserve is seldom found alone.

Following the illustration already mentioned, if a sinking fund reserve were required by the trust deed in addition to the sinking fund, an additional entry on December 31, 1915, would be necessary:

-December 31, 1915-

Profit and loss	$33,581.75	
To--Sinking Fund Reserve		$33,581.75
To set up reserve for Instalment #1, as per the provisions in the trust deed, Section 5.		

The same entry would again be made on December 31, 1916, and the following entry would record the interest reported by the trustee:

-December 31, 1916-

Sinking Fund Trustee	$1,343.27	
To--Sinking Fund Reserve		$ 1,343.27
Interest at 4% earned on instalment paid December 31, 1915.		

When the bonds are redeemed, the sinking fund reserve is available for any purpose the company may desire. Sometimes a stock dividend is declared from it; in other cases it is credited in whole or part to other reserves; or the amount may be written back to Surplus (from which it came) by the following entry:

-December 31, 1935-

Sinking Fund Reserve	$1,000,000.00	
To--Surplus		$1,000,000.00
To write back reserve to Surplus by order of Board of Directors; see their minutes, page......		

In some cases the trust deed provides that a portion of the reserve may be released as the bonds are repurchased for cancellation.

<u>ON THE BALANCE SHEET</u>--The amounts paid to the sinking fund trustee may be designated under the title of "Sinking Fund" on the balance sheet, or "Sinking Fund Assets," and will appear between capital and current assets.

The reserve will appear as "Sinking Fund Reserve" under "Appropriated Surplus," or may be shown separately between current liabilities and surplus, or under the general heading of "Net Worth."

A sinking fund may be created also to retire preferred stock or for other purposes.

REFERENCES:

Bennett, pages 279-319
Hatfield, pages 261-272
Journal of Accountancy, Vol. VI, page 394

COMPLETE ACCOUNTING COURSE--PART I

Lecture 25

STOCK AND BOND INVESTMENTS

MISCELLANEOUS QUESTIONS

Question 76--

(a) Which yields the larger income, 6% stock at 148% or 4½% stock at 112%?

(b) What per cent stock can be bought at 119%, brokerage ⅛% additional, to yield 5% on the investment?

Question 77--The Brightmire Manufacturing Co. has a bond issue of $500,000 maturing June 1, 1917, which has run for fifteen years. The bonds were originally issued at 95½ (par value $1,000, interest at 6% payable semiannually) and the expenses of floating the issue amounted to $1,530. Both a sinking fund and sinking fund reserve have been maintained, and the bonds are to be redeemed in cash. Give all the entries to be made on the books on June 1, 1917, assuming that the discounts have been kept correctly.

Question 78--P. J. Kirkwood purchased 100 of the bonds described in the previous question on February 1, 1912, at 97 and commission of 1/6%. What entries in his books relative to these bonds would you expect to find on or shortly after June 1, 1917?

Question 79--An Indiana corporation, a holding company, owns three-fourths of the capital stock of the Brightmire Manufacturing Co. and has taken up its portion of the profits of the subsidiary since the controlling interest was secured. Give entries on the books of the Indiana corporation to record the following facts:

(a) Profits of Brightmire Manufacturing Co. for year ending December 31, 1916, $150,000.

(b) Dividend declared January 5, 1917, $80,000.

(c) Above dividend paid in cash January 31, 1917.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

JUNE 16

By resolution of the board of directors, approved by a meeting of stockholders, an arrangement is made whereby 2,000 shares of the common stock of the Miller Motor Car Co. are exchanged for 1,500 shares (out of a total issue of 2,500 shares) of the capital stock of the Durant Truck Co. (Debit to "Investments.") Pay the bill of the U. S. Advertising Co. for May advertising. Pay B. F. Goodrich Co. invoice of June 6, and invoices of Stahl Steel Works and Washed Coal Co.

JUNE 18

Pay Pay-rolls to June 15:

Factory--Direct Labor	$18,953.25	
Indirect Labor	9,322.87	
Heat, Light, and Power	550.75	
Repairs	1,873.27	$30,700.14
Office--Office Salaries	$ 548.50	
Salesmen's Salaries	2,943.50	3,492.00
		$34,192.14

District sales managers' reports show sales of automobiles $65,875.00; accessories $9,472.87.

JUNE 19

Invoices are duly approved for the following shipments received today:

Automobile Accessories Mfg. Co., Finished Parts	$18,750.00	terms 2% 15 days, net 30 days
Williams and Richards, Shop Supplies	683.85	" 2% 15 " " 30 "
New Idea Lamp Co., Finished Parts	2,843.75	" 2% 10 " " 60 "
Standard Wheel Co., Finished Parts	5,875.00	" 2% 10 " " 30 "
Briscoe Radiator Co., Finished Parts	4,227.00	July 1
Ohio Steel Foundries Co., Raw Material	9,427.25	July 1

Collection report shows the following receipts:

From customers--notes $27,500; cash $19,283.26; discount allowed $782.98.

From notes receivable--$22,135, and interest $103.78.

JUNE 20

The bank presents a three-day sight draft for $20,000 drawn by the Crown Automobile Co. for finished cars purchased May 31. Accept the draft. Pay freight bills of Penn. R. R. Co. $826.36, of which $714.16 is chargeable to Finished Parts, $112.20 to Raw Material. Edmond Machinery Co. threaten to sue if their note is not paid. Send them check for $3,517.01. Fred Miller gives his check for the amount charged to his personal account.

JUNE 21

Receive notes in full of subscription due on common stock in pursuance to call of the board of directors.

JUNE 22

Receive from B. F. Goodrich Co. finished parts $10,483.50, terms 2% 10 days, net 30 days. Sundry allowances to customers, on account of finished parts, $1,831.47.

JUNE 23

Pay our acceptance of the 13th in favor of Western Motor Castings Co., and our acceptance of the 20th in favor of the Crown Automobile Co. Received of Westfield and Roe sundry repair parts for plant equipment $287.25, C. O. D. Overhaul the truck, using finished parts from stock amounting to $77.27.

JUNE 25

District sales managers' reports show sales of automobiles $58,185; accessories $7,983.78. Pay Western Printing Co. invoice of May 24; Williams and Richards invoice of June 19.

JUNE 26

Receive from the Quality Printers an invoice of $687.50, terms 1% 10 days, net 60 days. Distribute as follows: Miscellaneous Factory Expenses $107.50; Miscellaneous Selling Expenses $86.25; Stationery and Printing $493.75. Collection report shows receipts from customers as follows: notes $31,875; cash $20,138.98; discounts allowed $847.27. Notes receivable paid $15,375, with accrued interest, $78.25.

JUNE 27

Receive shipment from Washed Coal Co. $5,093.27, terms 2% 10 days, net 60 days, f.o.b. factory. Pay freight bills to Penn R. R. Co. $283.27 (Finished Parts). $873.28 of uncollected accounts are charged off (charge Reserve for Bad Debts).

JUNE 28

Notes given in full of common stock subscriptions on June 21 are paid. Give August Miller check for traveling expenses to date, $743.28. Receive from Best Drop Forge Works raw material amounting to $1,627, terms 2½% 5 days, net 30 days. Receive check from National Fire Insurance Co. for $383.75 in full settlement of damage caused by fire in paint shop June 3 (Repairs--Plant and Equipment).

JUNE 29

U. S. Advertising Co. presented bill for June advertising, amounting to $25,647.25. Pay same. Also pay the following invoices: New Idea Lamp Co., June 19; Standard Wheel Co., June 19.

Sell 400 shares of common stock at 95, and retire bank loan of $40,000. Send check of $600 to W. K. Jones for royalties on patented device used.

Solution to Problem 18 — Exhibit A

THE VANADIUM MANUFACTURING CO.
BALANCE SHEET, DECEMBER 31, 1917

ASSETS

	Cost	Reserve for Depreciation	Book Value
CAPITAL ASSETS:			
Real Estate	$ 30,000.00	$---------	$ 30,000.00
Buildings	50,000.00	11,500.00	38,500.00
Machinery and Equipment	175,000.00	52,500.00	122,500.00
Total	$255,000.00	$64,000.00	$191,000.00
Good-will			50,000.00
CURRENT ASSETS:			
Inventories:			
Finished and Partly Finished Goods		$25,000.00	
Raw Materials		15,000.00	
Accounts Receivable		8,000.00	
Cash in Bank		14,000.00	
Petty Cash Fund		500.00	62,500.00
			$303,500.00

LIABILITIES

CAPITAL STOCK AND SURPLUS:		
Preferred Stock--consisting of 1,200 shares of a par value of $100 each		$120,000.00
Common Stock--consisting of 2,500 shares without par value sold for	$125,110.00	
Surplus applicable to Common Stock:		
Balance, January 1, 1917	$ 23,190.00	
Profits for year ending December 31, 1917, per Exhibit B	8,800.00	
	$ 31,990.00	
Less--Dividends declared December 20, 1917	15,900.00	
Balance--Surplus	$16,090.00	
Book Value Common Stock		141,200.00
CURRENT LIABILITIES:		
Accounts Payable	$24,000.00	
Dividends Payable	15,900.00	
Accrued Taxes	2,400.00	42,300.00
		$303,500.00

Exhibit B

THE VANADIUM MANUFACTURING CO.
STATEMENT OF PROFITS AND INCOME
YEAR ENDING DECEMBER 31,1917

SALES			$450,000.00
Deduct--Cost of Sales (Exhibit C)			371,200.00
GROSS PROFIT FROM SALES			78,800.00
DEDUCT--SELLING AND GENERAL EXPENSES:			
Selling Expenses:			
Salesmen's Salaries and Commissions	$ 15,000.00		
Salesmen's Expenses	3,000.00		
Advertising	6,000.00	$ 24,000.00	
General Expenses:			
Officers' Salaries	$ 25,000.00		
Office Salaries	10,000.00		
General Expense	9,000.00	44,000.00	68,000.00
NET PROFIT FROM OPERATIONS			$ 10,800.00
DEDUCT--Sales Discounts Allowed			2,000.00
SURPLUS NET PROFITS (Exhibit A)			$ 8,800.00

Exhibit C

THE VANADIUM MANUFACTURING CO.
STATEMENT OF COST OF MANUFACTURE AND SALES
YEAR ENDING DECEMBER 31, 1917

MATERIALS USED		$247,000.00
DIRECT LABOR		75,000.00
PRIME COST		$322,000.00
FACTORY OVERHEAD:		
Heat, Light, and Power	$11,000.00	
Superintendence	10,000.00	
Maintenance and Repairs	5,000.00	
Depreciation	19,000.00	
Taxes	2,400.00	
Miscellaneous Factory Expenses	5,800.00	53,200.00
TOTAL MANUFACTURING COST		$375,200.00
DEDUCT--Increase in Finished and Partly Finished Goods:		
December 31, 1917	$25,000.00	
January 1, 1917	21,000.00	4,000.00
COST OF FINISHED GOODS SOLD (Exhibit B)		$371,200.00

Comments on Problem 18

The subject of capital stock without par value offers several interesting points of discussion.

1. There is some tendency to think that the amount received for a share of such stock when the stock is first marketed will fix a sort of par value, and when further portions of the stock are sold there is a tendency to regard the deficiency or excess realized under or over such imaginary par value as a debit or credit to surplus. (See article in Journal of Accountancy, Vol. 21, pages 294-297.)
2. Earnings would seem to be identified with the capital account as in the case of a partnership, but for various reasons the original investment should be kept separate.
3. Under the new excise tax law the "fair value" of the capital stock of a corporation is assessed with a yearly tax, thus reducing the importance of the term "par value" in the case of all classes of stock.

BOND PREMIUM AND DISCOUNT.

NATURE--If a corporation issues a bond having a par value of $1,000 for $900, the bond is said to be issued at 90 and the difference of $100 is referred to as bond discount. If this bond were sold for $1,100, the excess of $100 would be referred to as bond premium. In essence a bond is merely a note payable and the treatment of the discount on a bond should be identical with the treatment of discount on notes payable. The accepted rule is to spread such discounts over the term of the debt so as to charge each accounting period with its proportion of the discount. The cost to the issuing company is represented by the effective rate of interest, i.e., the sum of the nominal interest (interest paid at the regular interest dates) and the proportion of the bond discount charged off. Bond premiums would be dealt with likewise, each accounting period being credited with its proportion of the premium.

BOND EXPENSE--One of the factors determining the amount of discount is the expenses connected with a bond issue, such as attorneys', engineers', and auditors' fees, printing, etc. If paid by the lender, the discount will naturally be higher than if the expenses are paid by the borrower. Inasmuch as the latter method predominates, bond expense is generally added to the bond discount and the total amortized over the life cf the bonds. In this way bond expense enters into the effective interest.

AMORTIZATION--To amortize the debt discount and expense, the simplest procedure is to divide by the number of years the bond is to run. For example, $100,000 twenty-year 5% bonds are sold at 95 on January 1, 1917, the expenses of engraving, commission on sales, etc., being $2,000. Assuming the discount and expense to have been debited to "Bond Discount and Expense," the following entries will be made on June 30, 1917:

(1)

Interest (a nominal account)	$2,500.00	
To--Cash		$2,500.00
To record payment of semiannual interest in cash.		

(2)

Interest	175.00	
To--Bond Discount and Expense		175.00
To write down 1/40 of Bond Discount and Expense.		

Or, if the bonds are sold at 110 (less the expenses of $2,000), and are redeemable at par, entry (2) would be:

Premium on Bonds	$ 200.00	
To--Interest		$ 200.00
To write down 1/40 of Premium on Bonds.		

The 5% is called the "nominal" or "cash" rate, while the "effective" or "income" rate is the one which produces the correct charge to the interest account for the period. The process of prorating discount or premium over the life of the obligation is called "amortization." The effective rate as above computed is not theoretically correct but is near enough for ordinary purposes.

STOCK DISCOUNT AND PREMIUM

NATURE--When stock having a par value of $100 is sold for $95, the difference of $5 is referred to as "discount." Conversely, if sold for $110, the excess of $10 is referred to as "premium." Many states forbid the issue of stock at less than par on the theory that the issue of a certain amount of stock will lead investors and creditors to believe that assets equal to the par value have been received by the company. In Illinois the original issue of stock cannot be sold at less than par. In California the issue of stock at a discount is sanctioned, but stockholders at the same time are held liable, pro rata, for all debts of the corporation. In New York stock may be issued without par value and in such cases there can be no discount or premium.

TREATMENT ON BALANCE SHEET--Stock discount is preferably shown separately as a Deferred Charge. Sometimes it is merged with organization expenses such as incorporation fees, prospectus, legal fees, etc., and carried under that caption as a Deferred Charge, or as Intangible Capital. Premium on stock is preferably shown under that caption immediately following Capital Stock. Oftentimes it is merged with Capital Surplus.

DISPOSITION--The best practice is summed up by the Interstate Commerce Commission as follows: The discount "should be carried on the balance sheet until extinguished (1) by premiums realized on subsequent sales of stock, (2) by assessments levied on the stockholders, (3) by appropriations of income or free surplus for the purpose, or (4) by retiring the stock. When any stock is retired, the proper discount account should be adjusted by crediting to it an amount equal to the unextinguished discount on such stock."

Stock discount or premium differs fundamentally from debt discount or premium. The latter is part of the cost of money borrowed for a definite period and must be included in determining the effective interest expense. The former represents the amount by which the actual contributions by the proprietors are less than or more than the face value of the evidences of proprietorship (stock certificates) issued to them.

ENTRIES--Thus, the M N Company is capitalized at $100,000, consisting of 1,000 shares having a par value of $100 each, subscribed for at 85. The following entries are made:

Unsubscribed Stock	$100,000.00	
To--Capital Stock Authorized		$100,000.00
To record authorized issue.		
Subscriptions	85,000.00	
Discount on Stock	15,000.00	
To--Unsubscribed Stock		100,000.00
The entire issue is subscribed for at 85.		

If, after the first year, the directors vote to write off $5,000 of the discount:

Profit and Loss (or Surplus)	$ 5,000.00	
To--Discount on Stock		$ 5,000.00
To retire portion of the discount as per minutes of Board of Directors, page......		

If, in the above illustration, the stock is sold at 104, the following entry would be necessary:

Subscriptions	$104,000.00	
To--Unsubscribed Stock		$100,000.00
Premium on Stock		4,000.00
Subscriptions to entire issue at 104.		

INVESTMENT IN BONDS OF OTHER COMPANIES

VALUATION--Purchases of bonds of other companies should be charged to Investments account at cost. Subsequent treatment will depend on whether it is a permanent investment (to be held indefinitely) or a temporary investment (available for sale). In the former case, fluctuations in the market value should be ignored except where a drop in market value appears to be permanent, in which case the conservative policy would be to write it down. Temporary investments generally follow the rule of cost or market whichever is the lower. If a temporary investment is a quoted security readily salable, it is permissible in certain cases to use market value, whether it is more or less than cost.

AMORTIZATION AND ACCUMULATION--The premium or discount on a bond purchased is dealt with in the same manner as a premium or discount on bonds issued, viz., amortized over the term of the debt. In this manner the true income for the period is determined. However, in the case of bonds purchased it is customary to leave the discount or premium in the investment account instead of segregating this element as is done in the case of bonds issued.

ACCRUED INTEREST AT PURCHASE--Unless bonds are purchased on the dates interest collections are made, there will always be the purchase of accrued interest to consider. Thus, two $1,000 6% bonds, interest payable January 1 and July 1, are purchased May 16 for $2,040. Accrued interest from January 1 to May 16 will be:

$$\frac{4\frac{1}{2}}{12} \times \frac{6}{100} \times \$2{,}000, \text{ or } \$45$$

indicating that the two bonds cost $1,995 or 99¾ each.

Transactions with a bond house will clearly show just what portion of the price represents accrued interest. The following entry will be required for the transaction just stated.

Investment (or other asset account)	$1,995.00	
Accrued Interest on Investments	45.00	
To--Cash		$2,040.00
Purchase of two bonds No. ...... and ......, of the A B Company at 99¾ and accrued interest.		

INCOME--Interest accrues and becomes income from day to day. Practically it is taken up on the books at the end of each month or whenever financial statements are prepared. In the former case the following entry would be made:

Accrued Interest on Investments	$--------	
To--Income from Investments		$--------
To take up accrued interest at		

and when collected the following entry:

Cash	$--------	
To--Accrued Interest on Investments		$--------

BALANCE SHEET--Permanent investments should be shown between capital and current assets; temporary investments are current assets.

INVESTMENT IN STOCKS OF OTHER COMPANIES

VALUATION--An investment in the capital stock of another company may be a (1) permanent or temporary, or (2) a controlling interest (50+%) or less than a controlling interest.

All purchases of stock in other companies should be charged to an Investment account at cost. If a temporary investment, the rule of cost or market, whichever is the lower, is most commonly applied although a listed stock in some cases may be valued at market, irrespective of cost. A permanent investment is valued at cost. Should it appear that a permanent fall in value has occurred, conservative policy would require that the book value be reduced. In either case the par value may be ignored.

HOLDING COMPANY--A holding company is a corporation which controls other companies through ownership of a majority of the voting stock. In some states the statutes do not permit one corporation to acquire the capital stock of another, thus preventing the formation of holding companies.

INCOME--Income from stock is determined when a dividend is declared, at which time the following entry would be made:

Dividends Receivable	$--------	
To--Income from Investments		$--------
Dividend of ....% declared by A B Company on $.... par value of stock owned.		

and when collected:

Cash	$--------	
To--Dividends Receivable		$--------

Where the investment represents a controlling interest in a subsidiary corporation, the portion of profits earned since the acquisition of the controlling interest and applicable thereto, may be taken up as income on the books of the holding company when the profits are earned, rather than when the dividend is declared. The entry would be:

Investment in Controlled Company $--------
To--Profit and Loss $--------
To take up 75% of profits of X Y Company, for year ending .... as per their Statement of Profit and Income.

and when the dividend is collected:

Cash $--------
To--Investment in Controlled Company $--------

This procedure is based on the theory that all the surplus of a subsidiary is controlled by the holding company and may be distributed at will and hence should appear on the books of the holding company as soon as determined.

BALANCE SHEET--Permanent investments should appear between capital and current assets, investments in controlled companies appearing as a separate item. Temporary investments are usually classed as current assets.

REFERENCES:

Bennett, pages 252-278
Cole, Chapter XII
Esquerre, pages 261-291
Sprague, "Accountancy of Investment"

COMPLETE ACCOUNTING COURSE--PART I

Lecture 26

CAPITAL AND REVENUE EXPENDITURES

Problem 20

In your examination of the Automobile Delivery Truck account of a company, you find the following entries:

DEBITS		
Jan. 1, 1917, Trucks 1, 2, 3, 4, at $1,200		$4,800.00
July 1, 1917, Truck 5		1,500.00
Aug. 1, 1917, Truck 6		1,500.00
CREDITS		
Aug. 1, 1917, Truck 2		$ 900.00
Sept. 1, 1917, Truck 4		750.00
Balance, September 1, 1917	$6,150.00	

The Reserve for Depreciation of Automobile Delivery Truck account stood credited on January 1, 1917, with $1,800.

Upon analyzing the transactions represented by these items, you find the following facts:

1. Truck 5 purchased July 1 replaced Truck 1. The portion of the reserve for depreciation accumulated on January 1 for Truck 1 amounted to $900. Truck 5 was purchased on open account.

2. Truck 2 was traded in for $850 on the purchase of Truck 6 costing $1,500. The difference was paid in cash. The reserve which had been accumulated for depreciation on Truck 2 on January 1, amounted to $300.

3. Truck 4 was totally destroyed in an accident September 1. The reserve for depreciation on this truck amounted on January 1 to $300 and it was insured for $750.

Assume the rate of depreciation to be 25% per year.

Give journal entries which would properly record the above facts and show the balances of all accounts affected, as of September 1, 1917.

MISCELLANEOUS QUESTIONS

Question 80--A corporation manufacturing explosives was compelled to pay exorbitant rates for a very limited amount of insurance, and in consequence was obliged to install an automatic sprinkler system at a cost of $75,000. This additional fire protection enabled it to secure a full line of insurance, though in mutual companies, and at a much lower rate than was obtainable prior to such installation. At the end of the fiscal year the company received dividends from these mutual insurance companies, aggregating $2,000. To what account should the cost of the sprinkler system be charged and to what account should this dividend be credited? State your reasons fully.

Question 81--Should the following expenditures be charged to capital or to revenue:

(a) Repairs to machinery.
(b) Replacements of machinery and plant.
(c) Royalties on machines used but owned by outside parties.
(d) Brokerage on a piece of property purchased.
(e) Costs attending a mortgage given.
(f) Costs of patents, including lawyer's charges and government fee.
(g) Expenses of incorporation.

Give reasons for your answer in each case.

WORK TO BE DONE IN THE PRACTICE SET

SUMMARY OF TRANSACTIONS

JUNE 30

District managers' reports show sales of cars $40,875, and accessories $4,328.25. Collection report to date shows cash received from customers $16,483.25; discount allowed $538.71; notes received $28,750. Received on notes $11,437, and for accrued interest, $98.38. Gave petty cashier check for following petty cash disbursements: heat, light, and power $157.25; miscellaneous manufacturing expenses $48.27; traveling expenses $93.72; miscellaneous selling expenses $67.20; office salaries $122; total $488.44. Received $29.43 from an account receivable charged off June 27.

Depreciation of Buildings--2% per annum (including purchase of June 2)	
" " Machinery--10% " " " " " " "	
" " Delivery Equipment--15% per annum	
" " Office and Warehouse Fixtures--6% per annum (including purchase of June 2)	
Reserve for Bad Debts--½% of Gross Sales	
Taxes Accrued	285.67
Bond Interest Accrued	
Rent Paid in Advance	
Insurance Expired	76.67
Accrued Interest on Notes Receivable	315.92
Prepaid Interest on Bank Loan	
Provide a Reserve for Discounts to be taken by customers	1,800.00
Inventory of Coal	3,500.00
Stationery	100.00

Accrued pay-roll to date:

Factory:		
Direct Labor	$20,948.73	
Indirect Labor	11,848.27	
Heat, Light, and Power	583.20	
Repairs--Plant and Equipment	1,532.83	
Motor Truck Maintenance	31.27	$34,944.30

Office:		
Salesmen's Salaries	$ 3,547.50	
Officers' Salaries	2,500.00	
Office Salaries	657.75	6,705.25
		$41,649.55

Prepare:

(a) A trial balance of general ledger as of June 30, 19--

(b) Schedule of unpaid audited vouchers.

Solution to Problem 19

(Entry already made)
-April 1, 1917-

Cash in Sinking Fund	$10,000.00	
To--Cash		$10,000.00
Recording payment of instalment No. 8.		

-April 1, 1917-
(1)

Cash in Sinking Fund	1,250.00	
To--Sinking Fund Reserve (Income from Sinking Fund)		1,250.00
Coupons collected by trustee on X Y Company 5% bonds.		

-May 1, 1917-
(2)

Cash in Sinking Fund	450.00	
To--Sinking Fund Reserve (Income from Sinking Fund)		450.00
Coupons collected by trustee on A B Company 6% bonds.		

(3)

Cash in Sinking Fund	15,600.00	
To--Securities in Sinking Fund (Bonds of A B Company)		15,000.00
Sinking Fund Reserve		600.00
Bonds of A B Company held by trustee sold at 104, book value $15,000.		

(4)

Securities in Sinking Fund (Bonds of X Y Company)	36,000.00	
Accrued Interest on Sinking Fund Investments	150.00	
To--Cash in Sinking Fund		36,150.00
36 X Y Company 5% bonds purchased by trustee at par and accrued interest.		

(5)

Sinking Fund Reserve (Expenses of Sinking Fund)	$250.00	
To--Cash in Sinking Fund		$250.00
Commission paid by trustee on purchase and sale of bonds.		

-June 30, 1917-

(6)

Cash in Sinking Fund	240.00	
To--Sinking Fund Reserve (Income from Sinking Fund)		240.00
Interest on cash balances allowed by trustee for six months ending today.		

(7)

Sinking Fund Reserve (Expenses of Sinking Fund)	50.00	
To--Cash in Sinking Fund		50.00
Expenses of trustee paid as per his report.		

The accounts appearing in parentheses are the ones which would be used in case there was no sinking fund reserve.

On June 30, 1917, the sinking fund assets would appear as follows on the balance sheet:

Bonds of X Y Company	$86,000.00
Accrued Interest paid on above	150.00
Cash	1,190.00
	$87,340.00

ANSWERS TO QUESTIONS

Answer to Question 74--The entries in either case are the same, all income being credited to an "Income from Sinking Fund" or similar account, and all expenses being debited either to the income account or to a separate Expenses of Sinking Fund account, as in the solution to Problem 19. Or if a sinking fund reserve is maintained, the income and expense will be carried and debited, respectively, thereto.

Answer to Question 75--The theory of the sinking fund reserve rests on the assumption that the amount of profits withheld in the business by setting up the reserve will increase the assets and at the same time prevent such additional assets from being withdrawn by stockholders as dividends. Without an accompanying provision for the creation of "Sinking Fund Assets," it may happen that the funds represented by the reserve will be invested in additional capital assets or perhaps will be squandered, in either case no liquid funds being found on hand when the bonds are to be redeemed. Hence, while the reserve generally operates to protect the investor so far as the value of the underlying security is concerned, it does not assure him that funds will be on hand to pay the obligation at maturity.

CAPITAL AND REVENUE EXPENDITURES

DEFINITION--"Capital and Revenue Expenditures" has reference to the question--"Shall certain expenditures be treated as additions to capital assets or as operating expenses or otherwise?" The term is usually exclusive of expenditures other than those relating to capital assets.

NATURE OF PROBLEM--A building is erected, its cost included with other capital assets, and for a number of years is used for the purposes of the business for which it has been constructed. During that time a reserve for depreciation, based on a fifty-year life, has been accumulating, and all ordinary repairs, such as repainting, redecorating, replacing window-panes, etc., have been charged to an appropriate expense account and closed into Profit and Loss at the end of each year. Of ordinary repairs such as these there has been no question. None have added any value to the property and they have been treated properly as operating expenses.

But supposing expenditures out of the ordinary are incurred? A wall is torn down to make way for a new addition. Foundations are strengthened and considerable interior alterations are made necessary by installing new machinery. Machines already installed are shifted from one part of the building to another.

Some of the accounts to which these and other expenditures having to do with the extension or maintenance of capital assets may be charged are:

1. Capital Asset Accounts
2. Reserves for Depreciation
3. Operating Expenses
4. Surplus

1. PROPERTY ACCOUNTS--The discussion here is concerned with (a) property purchased and (b) property constructed by the business itself.

(a) PURCHASED PROPERTY. To the contract or invoice price which is chargeable to the capital asset account it is proper to add the costs of installation, such as freight-in, handling charges, and all other costs incurred before the asset is ready for use. Trade discounts, cash discounts, rebates and allowances should be deducted.

Sometimes assets are purchased in a depleted or worn-out condition. In this case the costs of bringing them to a state of normal efficiency are capital expenditures since more would have been paid for the assets had they been in a state of proper repair.

(b) PROPERTY CONSTRUCTED BY THE BUSINESS ITSELF. There are various methods in use for arriving at the cost of property constructed. One is that only materials used and direct labor expended (prime cost) are proper charges to construction. A second method often followed is to include as overhead (in addition to prime cost) those costs which will not continue after construction ceases and which have been incurred because of construction. In still other cases arbitrary percentages are added to the prime cost to cover manufacturing overhead and administrative expenses. A fourth method consists in charging to the asset account the market price if obtained from outsiders.

A rule supported most generally by accountants stands midway between the second and third methods outlined: to include materials and labor directly assignable to construction and that portion of overhead which represents cost actually applicable, whether composed of non-recurring charges or of regular overhead and administrative expenses. In the latter charge one might expect to find superintendence, engineering, part of the costs of the purchasing and receiving departments, and even interest. Charges for interest are generally limited to amounts actually paid or accrued during the period of construction, such as interest on bonds and interest on temporary borrowings for capital purposes.

Expenditures incurred on capital assets serving to increase the capacity of their output are usually additions to property accounts. But these expenditures to become capital charges must be made on assets which are otherwise operating efficiently; that is, they must not represent neglected repairs which of course might also result in an increased capacity of output as compared with the asset when in bad repair. Nor would expenditures the object of which is to lower the cost of output necessarily imply that value was being added to the property; the test would be, "Are there any additions or extensions to the normally functioning asset because of the expenditure?"

2. RESERVES FOR DEPRECIATION--Charges to depreciation reserves will in most cases be confined to the costs of old assets discarded or sold. Extraordinary repairs the result of which is to lengthen the life of the asset may as a rule be charged to the depreciation reserve, the effect being to extend the time during which depreciation is provided. Extraordinary expenses or repairs should not include amounts which represent delayed, deferred, or neglected repairs, since the latter are chargeable to past operations, not to the reserve.

3. OPERATING EXPENSES--All recurrent and ordinary expenses necessary to maintain an asset in a proper state of efficiency are classed as operating expenses.

REPAIRS AND RENEWALS is often the name of an account purely nominal in character, "renewals" referring to small or frequent replacements of integral parts of a single asset such as a machine. Thus, while the life of a certain printing press is ten or fifteen years, certain rollers and bearings must be replaced repeatedly at the end of every six or eight months. Renewals of small parts is in most cases treated as an expense and should not be confused with the renewal of the whole asset or a substantial part of the asset.

Frequently renewals of assets such as SMALL TOOLS are debited at once to expense accounts, leaving the asset account at its original figure, undepreciated. This method is to be recommended where the entire asset or most of it has a life of a year or less. In order that the book value of the asset may be neither too high nor too low, a periodical physical revaluation is provided for and an adjustment made between the asset and nominal account to bring the former into agreement with the inventory figure.

Other methods of handling capital and revenue expenditures are illustrated in the various treatments of additions to furniture and fixtures which may be found in practice. Besides the usual treatment accorded other capital assets may be mentioned:

(a) The inventory method as in the case of Small Tools, Delivery Equipment, etc.

(b) Writing off a larger amount for depreciation than is necessary.

(c) Closing out the original asset account by means of a reserve for depreciation or by charging it off directly to Profit and Loss and treating subsequent additions as expenses.

(d) Maintaining the original cost as an asset and writing off subsequent additions to Profit and Loss.

The error resulting from an application of these methods tends to be on the side of conservatism and a "secret reserve" may be created (the financial position of the business understated by the balance sheet).

4. SURPLUS--Charges to Surplus on account of capital assets would consist chiefly of neglected repair and maintenance charges and losses actually sustained in previous years but not written off until after the close of the period. An extraordinary loss, such as a fire loss, might also be charged to Surplus without first appearing in Profit and Loss. In some cases it may be necessary to make a finer differentiation of expenditures than above indicated, and Improvement Reserves, Deferred Charges, or Extraordinary Charges to Profit and Loss may be used for that purpose.

REFERENCES:
Dickinson, Chapter VII
Esquerre, pages 226-230

COMPLETE ACCOUNTING COURSE--PART I

Lecture 27

GOOD-WILL, PATENTS, COPYRIGHTS, AND TRADE-MARKS

GENERAL REVIEW QUESTIONS

Problem 21 (For General Review)

The Jones Lithographing Co. commenced the year 1917 with the following balance sheet:

JONES LITHOGRAPHING CO.

BALANCE SHEET, JANUARY 1, 1917

ASSETS

CURRENT ASSETS:			
Cash		$ 4,000.00	
Accounts Receivable		59,500.00	
Personal Accounts		10,100.00	
Inventories:			
Raw Materials		12,500.00	
Work in Progress		3,100.00	
General Expense (Office Supplies, Postage, etc.)		500.00	$ 89,700.00
DEFERRED CHARGES:			
Discount on Stock		$ 15,300.00	
Prepaid Commissions to Salesmen		9,670.00	
Working Fund		5,000.00	
Prepaid Insurance		1,030.00	31,000.00
CAPITAL ASSETS:			
Land		$ 45,000.00	
Buildings		259,000.00	
Machinery		240,000.00	
Fixtures:			
Factory	$160,000.00		
Gen. Office	6,000.00	166,000.00	
Investment in X Printing Co.		350,000.00	1,060,000.00
			$1,180,700.00

LIABILITIES

CURRENT LIABILITIES:		
Accounts Payable	$ 16,400.00	
Notes Payable	4,000.00	
Bank Loan	5,000.00	
Accrued Bond Int.	8,000.00	
Accrued Taxes	3,000.00	$ 36,400.00
FIRST MORTGAGE 20-YEAR 4% BONDS (due Jan. 1, 1921):		
Issued and Outstanding		400,000.00
RESERVES FOR DEPRECIATION:		
Buildings	$ 56,000.00	
Machinery	72,000.00	
Fixtures	40,000.00	168,000.00
OTHER RESERVES:		
Sinking Fund Reserve	$320,000.00	
Bad Debt Reserve	2,000.00	322,000.00
CAPITAL STOCK:		
Issued and Outstanding	$500,000.00	
Deficit, Jan. 1, 1917	245,700.00	254,300.00
		$1,180,700.00

Personal accounts on January 1, 1917, were:

D. R. Jones, President--Drawing Account	$ 6,650.00
W. R. Single, Vice-President--Drawing Account	3,450.00
	$10,100.00

"Investment in X Printing Co." is the cost of 3,000 shares (out of a total issue of 5,000 shares) which were acquired in 1911 by the present owners through exchange of one share of X Printing Co. stock for every 1 1/6 shares of Jones Lithographing Co. stock. Accounts payable at January 1 were on account of raw material purchases $9,500; heat, light, and power, $5,900; and general expense $1,000.

Cash receipts and disbursements during the year 1917 have been summarized as follows:

RECEIPTS

Customers on Account	$ 831,000.00	
Notes Payable	10,000.00	
Bank Loans	75,000.00	
Cash Sales	102,000.00	
Sale of Machinery Scrapped in 1917 (cost $5,000, reserve provided $3,800)	1,200.00	
Dividend on X Printing Co. Stock	7,000.00	
Refund from Barr Chemical Co. (paid bill twice to them for purchase of raw materials)	150.00	
TOTAL RECEIPTS		$1,026,350.00

DISBURSEMENTS

Accounts Payable:		
Raw Material Purchases	$ 575,000.00	
Manufacturing Supplies	8,500.00	
Heat, Light, and Power	15,100.00	
Additions to Buildings	92,300.00	
New Machinery Purchases (replacing old machinery scrapped costing $10,000; reserve provided $10,000. This item is not related to the one appearing above.)	11,500.00	
Extraordinary Repairs on Fixtures (Factory)	2,500.00	
Prepaid Insurance	1,950.00	
Direct Labor	125,000.00	
Indirect Labor	11,000.00	
General and Administrative Expense	15,400.00	
Prepaid Commissions to Salesmen	21,600.00	
Commissions to Salesmen	10,200.00	
Notes Payable	12,000.00	
1916 Taxes	3,000.00	
Bank Loans	70,000.00	
Bond Interest	16,000.00	
D. R. Jones--Drawing Account	10,000.00	
W. R. Single--Drawing Account	8,000.00	
Sundry Manufacturing Expenses	14,150.00	$1,023,200.00
BALANCE ON HAND, December 31, 1917		7,150.00

Sales during the year charged to customers totalled $840,000; allowances during the year on the gross amount were $8,450; cash discounts allowed customers $2,400; accounts proving worthless and charged to reserve during 1917, $1,100; total accounts outstanding which are regarded as uncollectible at December 31, 1917, $2,250.

Credit to D. R. Jones, president and general manager, on account of salary for 1917, $12,000; credit to W. R. Single, vice-president and general superintendent of manufacturing operations (chargeable as factory burden), $6,000.

Inventory of raw materials at December 31, 1917, $9,800; of work in progress, $4,500; of postage, $500. All work being done on a contract basis, there is no finished stock.

In view of the profits earned during the year, the directors vote to write off $5,000 of the discount on stock. Prepaid commissions to salesmen at December 31, 1917, are $8,140; prepaid insurance $1,110; the president reports that while on January 1, 1917, he had the $5,000 working fund on hand, at December 31 but $1,000 remains, the difference being chargeable to Promotion (Selling) Expense.

Accounts payable December 31, 1917, are $5,100 for raw material purchases, and general expense items $900; total $6,000.

Provide as follows for depreciation, using as a basis the balances of the ledger accounts at cost at December 31, 1917: buildings 5%; machinery 10%; fixtures 15%.

Accrued taxes at December 31, 1917, consist of the following:

Property Taxes	\$945.00
Income Tax and Capital Stock Tax (estimated)	\$962.30

The regular increment to the sinking fund reserve should be made.
From the information above prepare:

(a) Balance sheet at December 31, 1917.
(b) Statement of profit and loss for year ending that date.

The balance sheet may be rearranged in any way.

GENERAL REVIEW QUESTIONS

Question 82--Give the procedure to be followed when attempting to ascertain the amount of profit or loss of an enterprise whose accounts have been kept on the single-entry basis.

Question 83--Wherein do trial balances and balance sheets differ?

Question 84--What is the purpose of grouping assets and liabilities, so as to show the separate totals of the fixed and current assets and liabilities when preparing balance sheets?

Question 85--Differentiate between capital and revenue expenditures. Illustrate.

Question 86--Differentiate between the following terms--expenditure, disbursements, expense, receipts, income.

Question 87--Should goods, which have been sent out on consignment, be credited to sales account and charged to the consignee when recording such consignment on the books? Give reasons for your answer.

Question 88--Outline a method of handling consignments-outward involving the use of a subsidiary consignments-outward ledger.

Question 89--Outline a method of handling consignments-inward involving the use of a subsidiary consignments-inward ledger.

Question 90--What is a joint venture? Describe a simple method of accounting for a venture between A, B, and C, A acting as the manager of the venture, B advancing the merchandise shipped, and C collecting the proceeds.

Question 91--Describe briefly two ways of accounting for accruing income and expense, using as an illustration interest accrued or notes payable.

Question 92--What is the underlying reason for excluding from merchandise inventory valuations the increase in market value over cost price of goods on hand in those cases where, if the market value is less than the cost price, the loss is taken into account?

Question 93--Name two advantages derived from the method of keeping a separate cash fund out of which all petty expenses are paid with currency.

Question 94--What advantage is derived from the practice of entering cash sales daily in the sales journal and charging the cash received to a cash sales or cashier's account in the customers ledger, instead of simply crediting such sales direct from the cash book to the Sales account?

Question 95--Name and describe the chief partnership accounts not common to a corporation.

Question 96--By and under what authority does a corporation operate?

Question 97--Differentiate between treasury stock and unissued stock.

Question 98--How would you dispose of the difference between par value and selling price, where treasury stock is sold for less than par? Where treasury bonds are sold for less than par.

Question 99--On the balance sheet of the X Y Z Company, among the items under the heading of "Liabilities" appeared the following:

1--6% Preferred Capital Stock	$200,000.00
2--First Mortgage 6% Gold Bonds	200,000.00

What difference, if any, is there between these two liabilities, assuming the stock is preferred both as to dividends and assets?

Question 100--What difference is there in the nature of security for the following kinds of bonds: First Mortgage; Income; Municipal?

Question 101--Assuming that an entire issue of bonds ($100,000 par value) yielded $105,000 through sale, after all expenses in connection with floating the issue were paid, how would you record the receipt of the amount in excess of par value, and what disposition would you make of such item?

Question 102--Can surplus be created in any other way than through profits earned from operations?

Question 103--What entry should be made in the books of account of a corporation with respect to dividend authorized by the board of directors, even though payment of such dividend may be indefinitely deferred?

Question 104--Is it proper under any circumstances to borrow cash with which to pay dividends?

Question 105--Why is it necessary to include in a revenue statement or profit and loss account, an amount to represent depreciation of plant and equipment, when such plant and equipment have been maintained to the highest degree of efficiency through repairs and renewals, and when to replace same, even in their used or second-hand condition, would cost considerably more than the original purchase price?

<u>Question</u> <u>106</u>--Assuming that a reserve had been set up in the accounts at December 31, 1916, to provide for bad and doubtful accounts, how would you treat an account which appeared on the books at that date, but which becoming uncollectible in 1917, is to be charged off?

<u>Question</u> <u>107</u>--Differentiate between a reserve set aside out of earnings (a) for retirement of bonds or any other debt; (b) for depreciation of fixed assets.

<u>Question</u> <u>108</u>--When, and under what circumstances, is it most proper to bring into the accounts an amount to represent the value of good-will?

<u>Question</u> <u>109</u>--What do you understand by the phrase, "Capitalize such earnings as exceed the ordinary interest return on the investment?"

<u>Question</u> <u>110</u>--What do you understand by the term "Consolidated Balance Sheet," and in what class of corporations are such balance sheets used?

<u>Question</u> <u>111</u>--Give the principles underlying the perpetual inventory, and state the advantages derived from its use? How are perpetual inventory accounts related to controlling accounts?

<u>Question</u> <u>112</u>--Explain three methods of providing for depreciation which are in general use.

<u>Question</u> <u>113</u>--Give some of the essential elements of the voucher system. Under what circumstances would the use of the modern voucher system be inadvisable?

<u>Question</u> <u>114</u>--If you were the clerk in charge of the voucher register and a voucher were handed to you for entry, what approvals would you look for?

ANSWERS TO QUESTIONS

<u>Answer</u> <u>to</u> <u>Question</u> <u>76</u>--

1. Assuming the par value in each case to be \$100, the actual return on the 6% stock will be \$6 a year, which is $\frac{6}{148\frac{7}{8}}$ or 4.03% on the investment. The 4½% stock will yield 4.004% $\left(\frac{4.50}{112\frac{3}{8}}\right)$ on the investment; hence, the first stock is preferable as to income.

2. The investment will be represented by the price paid for the stock plus costs of purchase, in this case 119⅞+⅛, or 120. If, for every \$120 invested, it is desired to obtain a 5% income, or \$6, it is apparent that a 6% stock must be purchased.

Answer to Question 77--

-June 1, 1917-

(1)		
Interest on Bonds	$ 15,000.00	
To--Cash		$ 15,000.00
Final instalment of interest paid to bondholders.		
(2)		
Sinking Fund Trustee	33,333.33	
To--Cash		33,333.33
Final instalment of sinking fund paid to sinking fund trustee.		
(3)		
Provision for Sinking Fund Reserve	33,333.33	
To--Sinking Fund Reserve		33,333.33
To record yearly provision for sinking fund.		
(4)		
Interest on Bonds	1,602.00	
To--Bond Discount and Expense		1,602.00
To close out proportion of bond discount and expense for year.		
(5)		
Bonds Outstanding	500,000.00	
To--Sinking Fund Trustee		500,000.00
Payment of bonds by trustee.		
(6)		
Sinking Fund Reserve	500,000.00	
To--Surplus		500,000.00
To write back sinking fund reserve per resolution of the Board of Directors. See minute book, page.....		

Answer to Question 78--Periodically the purchaser will have increased his bond investment account so that at maturity it will appear on his books at $100,000, the final entry necessary to raise it to this value being:

-June 1, 1917-

(1)		
Investment in B Manufacturing Co. Bonds	$ 566.67	
To--Income from Bonds		$ 566.67
Proportion of difference between cost and redemption price of bonds (on yearly basis).		
(2)		
Cash	3,000.00	
To--Income from Bonds		3,000.00
Semiannual interest coupons.		

Cash	$100,000.00	
To--Investment in B Manufacturing Co. Bonds		$100,000.00
Surrender and redemption in cash, being due June 1, 1917.		

Answer to Question 79--

-December 31, 1916-		
Investment in B Manufacturing Co. Stock	112,500.00	
To--Income from Subsidiaries		112,500.00
To take up our portion of profits as per their Statement of Profits and Income.		
-January 5, 1917-		
Dividends Receivable from Subsidiaries	60,000.00	
To--Investment in B Manufacturing Co. Stock		60,000.00
Dividend declared this date.		
-January 31, 1917-		
Cash	60,000.00	
To--Dividends Receivable from Subsidiaries		60,000.00
Dividend declared January 5, 1917, paid today.		

GOOD-WILL

DEFINITION--"Good-will represents the value of business connections, the value of the probability that present customers will continue to buy, in spite of the allurements of competing dealers." (Hatfield) In the average business, even though long established and well patronized, the item good-will ordinarily will not be found in the accounts, unless a reorganization or purchase of another business has taken place.

VALUATION--A computation of good-will is based (1) on the existence of surplus earnings over a reasonable return on the capital investment, or (2) on the excess of the par value of securities exchanged over the accepted value of the net tangible assets taken over.

The value of excess earnings is determined according to any one of three methods as follows:

(a) Capitalize the average net profits and deduct the value of tangible assets. Thus, if the average yearly net profits are $15,000 and a reasonable return is estimated at 6%, the capital necessary to produce this income is $\frac{15,000}{.06}$ or $250,000. Assuming the accepted value of the tangible assets to be $180,000, the good-will valuation will be $70,000.

(b) If excess earnings are considered uncertain for the future it may be desirable to capitalize them at a higher rate. The yearly net profits being $15,000, and a fair return on the capital invested considered as 6% of $180,000, or $10,800, the income attributable to the asset good-will is $4,200 which, capitalized at 10%, amounts to $42,000 ($\frac{4,200}{.10}$).

(c) A number of years' purchase of the average net profits. The application of this rule varies according to whether "net profits" is taken to mean before or after providing for a fair return of the invested capital, owner's salary, depreciation, etc. Usually the computation is made after allowing for all these deductions and multiplying the result by the agreed number of years. In the illustration cited the excess profits, after deducting a fair return on the capital invested, were $4,200. Based on a five years' purchase of these excess profits, the good-will valuation is $21,000. In the preceding paragraph the valuation of good-will there shown is equivalent to a ten years' purchase of the excess profits.

2. Whenever the par value of the securities of a new corporation exceeds the accepted value of the assets of a business exchanged for the securities, it is the practice to show the difference as good-will. The computation should be based on one of the methods just described, otherwise the stock is termed "watered." It was formerly common on the books of a new corporation to find a single Plant account which was debited with the par value of securities issued, but the practice has been strongly discouraged by accountants.

CHANGING VALUATION OF GOOD-WILL--Any change in the value of the asset of good-will should be referred to as FLUCTUATION, not DEPRECIATION or APPRECIATION. Such fluctuation is the direct result of an increase or decrease in earnings, and it is obvious that this fluctuation itself should not in any way increase or decrease earnings.

It follows that good-will need not be charged off for the purpose of stating true earnings. The desirability of charging off good-will is a question to be passed upon by the management, and any amount charged off would represent an appropriation of profits rather than an expense. In connection with this proposed treatment the following quotations will be of interest:

"And where it is clear that the valuation of the good-will was erroneous, that it is not worth its book value, the best method of adjusting is that advocated by Dicksee, to offset the decline in its value by a reduction of capital, not by a charge against profits." (Hatfield)

"As good-will does not suffer wear and tear, does not become obsolescent, is not used up in the operation of business, depreciation, as such, cannot be charged against it." (Montgomery)

Good-will varies from day to day and its value is unknown until the business is disposed of. Its uncertain value is the chief argument for its elimination from the books.

PATENTS, COPYRIGHTS, AND TRADE-MARKS

Patents, copyrights, and trade-marks are rights issued by the federal government to individuals or businesses allowing the exclusive use of these rights for a certain period of time. A patent is issued for seventeen years, a copyright for twenty-eight years (renewable for an additional fourteen years), and a trade-mark for thirty years (renewable for an additional thirty years). A small fee is paid the government at the time of registration.

Patents are valued at cost, including legal fees and other costs of maintaining title to them. Although their life may be reckoned as seventeen years, and depreciation provided accordingly, it is more conservative to write off their costs in a much shorter time. Similar patents may be secured by rival concerns or improved substitutes introduced with the result that a patent or series of patents may become valueless. Some patents taken out or purchased may immediately prove worthless, in which case their cost should be written off at once.

Copyrights and trade-marks follow the same general rule, i.e., should be valued at cost and generally depreciated more rapidly than the period of their protection would indicate, for the reason that their future value is uncertain.

In many cases patents, trade-marks, and copyrights are viewed as good-will and as such would not be written off for the reasons previously mentioned.

REFERENCES:

Hatfield, pages 107-118
Montgomery, pages 123-128
Wildman, Chapters XXV and XXIII

COMPLETE ACCOUNTING COURSE--PART I

Lecture 28

CONSOLIDATIONS

WORK TO BE DONE IN THE PRACTICE SET

Total raw material requisitions issued during month $18,897.04.
Finished parts used in production $45,109.16.
Finished parts sold $25,724.33.
Work in Progress transferred to Finished Stock, $142,725.39.
Cost of automobile sales $175,543.64.

From this information prepare closing entries, balance sheet as of June 30, and a statement of profit and loss for the month ending that date.

Solution to Assignment I-26-2

MILLER MOTOR CAR CO.
TRIAL BALANCE, JUNE 30, 19--

	DEBIT	CREDIT
Land	$ 40,000.00	$
Buildings	70,000.00	
Reserve for Depreciation on Buildings		200.00
Machinery, Tools, and Equipment	165,603.50	
Reserve for Depreciation on Machinery, Tools and Equipment		2,213.36
Office and Warehouse Fixtures	2,045.00	
Reserve for Depreciation on Office and Warehouse Fixtures		17.48
Delivery Equipment	1,750.00	
Reserve for Depreciation of Delivery Equipment		43.76
Good-will	66,000.00	
Investments	200,000.00	
Inventory of Automobiles	63,368.25	
Inventory of Work in Progress	31,710.17	
Inventory of Raw Materials	5,870.40	
Inventory of Finished Parts	22,774.08	
Inventory of Miscellaneous Supplies	3,600.00	
Customers' Accounts	104,013.40	
Notes Receivable	116,003.00	
Accrued Interest on Notes Receivable	315.92	
Reserve for Bad Debts		1,522.75
Reserve for Discounts		1,800.00
Cash in Bank	50,186.45	
Petty Cash Fund	500.00	

Advances to Salesmen	$ 2,000.00	$
Unexpired Insurance	766.66	
Rent Paid in Advance	100.00	
Discount on Stock	2,000.00	
Capital Stock--7% Preferred		100,000.00
Capital Stock--Common		500,000.00
Unissued Common Stock	66,100.00	
5% First Mortgage Bonds		150,000.00
6% First Mortgage Bonds		75,000.00
Audited Vouchers		60,144.12
Accrued Bond Interest		4,625.00
Accrued Taxes		2,295.34
Accrued Pay-roll		41,649.55
Surplus		4,515.02
Sales--Automobiles		235,385.00
Allowances on Sales--Automobiles	1,854.00	
Sales--Finished Parts		39,191.08
Allowances on Sales--Finished Parts	2,052.75	
Discount on Sales--Finished Parts	4,990.51	
Discount on Purchases		1,129.82
Interest Received		717.43
Purchases--Raw Material	16,767.44	
Purchases--Finished Parts	66,523.13	
Direct Labor	39,901.98	
Indirect Labor	21,171.14	
Repairs, Plant, and Equipment	3,309.60	
Heat, Light, and Power	5,459.75	
Royalties	600.00	
Shop Supplies	683.85	
Depreciation	1,496.70	
Insurance	76.67	
Taxes	285.67	
Miscellaneous Factory Expenses	155.77	
Salesmen's Salaries	6,491.00	
Salesmen's Traveling Expenses	837.00	
Advertising	25,647.25	
Delivery Equipment Maintenance	108.54	
Depreciation on Delivery Equipment	21.88	
Miscellaneous Selling Expenses	203.45	
Officers' Salaries	2,500.00	
Office Salaries	1,328.25	
Depreciation on Office and Warehouse Fixtures	10.23	
Stationery and Printing	593.75	
Bad Debts	1,449.63	
Bond Interest	1,000.00	
Interest Paid	222.94	
	$1,220,449.71	$1,220,449.71

Prepare and post entries necessary to close books at June 30.

Solution to Problem 20

-July 1, 1917-

(1)

Operating Expense (Depreciation)	$ 150.00	
To--Reserve for Depreciation		$ 150.00
Depreciation from January 1 to July 1 on Truck 1.		

(2)

Operating Expense (Depreciation)	21.43	
Surplus	128.57	
Reserve for Depreciation	1,050.00	
To--Automobile Delivery Truck Account		1,200.00
Truck 1 scrapped. Shortage in provision for depreciation pertaining to prior years charged direct to Surplus account.		

(3)

Automobile Delivery Truck Account	1,500.00	
To--Accounts Payable		1,500.00
Truck 5 purchased.		

-August 1, 1917-

(4)

Operating Expense (Depreciation)	175.00	
To--Reserve for Depreciation		175.00
Depreciation from January 1 to August 1 on Truck 2.		

(5)

Automobile Delivery Truck Account(#6)	1,500.00	
To--Automobile Delivery Truck Account (#2)		850.00
Cash		650.00
Purchase of Truck 6 in exchange for Truck 2 and cash.		

(6)

Reserve for Depreciation	475.00	
To--Automobile Delivery Truck Account		350.00
Surplus		78.95
Operating Expense (Depreciation)		46.05
To write off balance of account with Truck 2 exchanged, and to credit back over-provision for depreciation.		

-September 1, 1917-

(7)

Operating Expense (Depreciation)	200.00	
To--Reserve for Depreciation		200.00
Depreciation from January 1 to September 1 on Truck 4.		

(8)

Reserve for Depreciation	500.00	
Insurance Adjustment Account	700.00	
To--Automobile Delivery Trucks		1,200.00
Truck 4 totally destroyed.		

(9)

Cash	$750.00	
To--Insurance Adjustment Account		$750.00
Proceeds from insurance carried on Truck 4.		

(10)

Insurance Adjustment Account	50.00	
To--Profit and Loss		50.00
Excess of proceeds over book value of Truck 4.		

(11)

Operating Expense (Depreciation)	293.75	
To--Reserve for Depreciation		293.75
Provision for depreciation to September 1 of following trucks:		

#3-8 months	$200.00
#5-2 months	62.50
#6-1 month	31.25
	$293.75

The above entries having been made and posted, the Auto Delivery Truck Account will have a balance of $4,200, representing the cost of the trucks on hand (#3, 5, and 6); the Reserve for Depreciation will contain a balance of $593.75, the accrued depreciation to date on the three trucks.

ANSWERS TO QUESTIONS

Answer to Question 80--The cost of the sprinkler system should be charged to some equipment (capital asset) account, and depreciation written off from year to year and debited to manufacturing operations.

Dividends received from the mutual insurance companies at the end of the year should be credited to Insurance Expense account since they represent a return of part of the premium paid at the beginning of the year. Dividends of this nature should not be confused with dividends from investments, the latter being an earning, the former a reduction of an expense.

Answer to Question 81--

(a) Revenue.

(b) Capital; care being taken that the old assets replaced are written off.

(c) Revenue, unless part of the royalties apply on a purchase agreement, in which case they would be prorated as between capital and revenue.

(d) Capital, the item being one of the costs necessary in obtaining the asset.

(e) A deferred charge to be written off over the life of the mortgage.

(f) Capital charge to be written off during the life of the patent, if not sooner.

(g) A deferred charge to be written off within three or five years. Often permanently capitalized in the case of public utility corporations.

CONSOLIDATIONS

ADVANTAGES--The advantages of consolidation may be briefly summed up as follows:

1. Decrease expenses, such as duplicate salesmen, executive officials, accounting departments, etc.

2. Specialization on certain lines by the constituent components, eliminating duplication in manufacturing and equipment.

3. Ability to hire the best men, since the cost is distributed over all the constituent components and not borne entirely by any one.

4. Larger profits through obtaining a partial monopoly and maintaining sales prices at a higher level.

5. Better facilities for borrowing money and obtaining additional capital.

METHODS USED--The combination of two or more companies into a single organization may be effected through (1) merger or (2) holding company.

A merger is the complete amalgamation of the constituent companies into a single company. The latter may be a new corporation or one of the constituent companies. In either case the new organization would acquire the net assets of all the other companies which would then be dissolved.

An alternate procedure is to organize a new company for the purpose of controlling the constituent companies through the ownership of a majority of the stock of each constituent company. The latter retain their separate corporate existence and operate as distinct organizations as heretofore. The control by the holding company arises through the election of a majority of the board of directors of each company. Under this method the holding company is usually the financial organization and the subsidiaries are manufacturing or selling organizations.

A new company need not be organized where the laws of a state permit one of the constituent companies to acquire controlling interests in the other companies.

EFFECT ON ACCOUNTING PROCEDURE--

1. MERGED COMPANY. The accounts in this case would not differ from those of any other corporation.

2. SUBSIDIARY COMPANY. There would be no change in the financial accounts of the subsidiary of a holding company. The only change would be on the stock ledger recording the transfer of shares from one set of stockholders to another. Sometimes there appears an additional asset of "Advances to Holding Company," or an additional liability of "Advances from Holding Company."

3. HOLDING COMPANY. The accounts peculiar to a holding company are:
Assets--Investments in Subsidiaries; Advances to Subsidiaries
Liabilities--Advances from Subsidiaries

If the holding company is merely a financial organization and does not engage also in manufacturing and selling activities, its chief source of income is dividends from subsidiaries and its principal expenses would be incurred on account of the executive staff. Sometimes these expenses are prorated among the subsidiaries as cost of services rendered such subsidiaries by the holding company.

CONSOLIDATED BALANCE SHEET--This is not the balance sheet of the holding company, nor of any legal entity whatsoever. It is a statement set up in conventional balance sheet form, designed to set out the true financial condition of the holding company and its subsidiaries viewed as a single organization at a particular moment of time and as a going concern.

The method of preparing this statement is illustrated in Problem 22. Similar assets and liabilities of all companies are totalled. Intercompany transactions are omitted since the total amount which the companies owe one another must equal the total amount which is due from one another; and considered as one unit these transactions have no bearing on the financial position. If the investment in subsidiary companies was made at book value, then it is equal to and offsets the capital stock and surplus of all the subsidiaries. It is obvious that the effect of this procedure is to substitute the net assets of the subsidiary in lieu of the asset of investment in subsidiary company.

CONSOLIDATED PROFIT AND LOSS STATEMENT--The same method is pursued in preparing the profit and loss statement. Dividends paid by one company to another are ignored, and only the dividends of the holding company shown. The object is to show the result from operations of all the companies considered as one unit in their relations to outsiders.

Problem 22 (Class Work)

The General Manufacturing Co. was organized on January 1, 1917, with an authorized capital stock of $300,000 divided into 3,000 shares at $100 each. On the same date they acquired on the open market the entire issue of capital stock of the Williams-Smith Co. (2,000 shares, par value $100), giving in exchange 2,400 shares of stock of the General Manufacturing Co. During the year the remaining 600 shares of the General Manufacturing Co. were disposed of at par for cash.

On January 1 and December 31, 1917, trial balances abstracted from the books of the Williams-Smith Co. stood as follows:

ASSETS

	JAN. 1	DEC. 31
Plant and Equipment	$175,000.00	$180,000.00
Inventories	43,500.00	57,100.00
Customers' Accounts	35,450.00	31,500.00
Cash	14,050.00	17,900.00
	$268,000.00	$286,500.00

LIABILITIES

	JAN. 1	DEC. 31
Capital Stock	$200,000.00	$200,000.00
Audited Vouchers	28,000.00	34,500.00
Surplus--Balance, January 1	40,000.00	40,000.00
Profits for year	----------	12,000.00
	$268,000.00	$286,500.00

On December 31, 1917, the balance sheet of the General Manufacturing Co. was prepared as follows:

ASSETS

INVESTMENT IN WILLIAMS-SMITH CO.		$240,000.00
CURRENT ASSETS:		
Merchandise Inventory	$40,000.00	
Customers' Accounts	25,000.00	
Cash	15,000.00	80,000.00
		$320,000.00

LIABILITIES

CAPITAL STOCK	$300,000.00
CURRENT LIABILITIES:	
Audited Vouchers	15,000.00
SURPLUS:	
Profit for year	5,000.00
	$320,000.00

Prepare a consolidated balance sheet of the two companies for December 31, 1917.

<u>Solution to Problem 22</u>

To show the profits of the Williams-Smith Co. on the books of the General Manufacturing Co., the following journal entry would be made on the books of the latter:

Investment in Williams-Smith Co.	$12,000.00	
To--Profit and Loss		$12,000.00
To take up the profits for 1917 of the Williams-Smith Co. as per their statement of profits and income dated December 31, 1917.		

The following consolidated working sheet would then be prepared:

GENERAL MANUFACTURING CO.
AND WILLIAMS-SMITH CO.
CONSOLIDATED WORKING SHEET, DECEMBER 31, 1917

ASSETS

ACCOUNT	GENERAL MFG. CO.	WILLIAMS-SMITH CO.	INTERCOMPANY ADJUSTMENTS	COMBINED
Plant and Equipment	$----------	$180,000.00	$----------	$180,000.00
Investment in Williams-Smith Co.	252,000.00	----------	----------	----------
Par Value	----------	----------	(A)200,000.00	----------
Surplus	----------	----------	(B) 52,000.00	----------
Inventories	40,000.00	57,100.00	----------	97,100.00
Customers' Accounts	25,000.00	31,500.00	----------	56,500.00
Cash	15,000.00	17,900.00	----------	32,900.00
	$332,000.00	$286,500.00	$252,000.00	$366,500.00

LIABILITIES

ACCOUNT	GENERAL MFG. CO.	WILLIAMS-SMITH CO.	INTERCOMPANY ADJUSTMENTS	COMBINED
Capital Stock--G. M.	$300,000.00	$----------	$----------	$300,000.00
Capital Stock--W. S.	----------	200,000.00	(A)200,000.00	----------
Audited Vouchers	15,000.00	34,500.00	----------	49,500.00
Surplus--G. M.	17,000.00	----------	----------	17,000.00
Surplus--W. S.	----------	52,000.00	(B) 52,000.00	----------
	$332,000.00	$286,500.00	$252,000.00	$366,500.00

GENERAL MANUFACTURING CO.
AND WILLIAMS-SMITH CO.
CONSOLIDATED BALANCE SHEET, DECEMBER 31, 1917

ASSETS			LIABILITIES	
CAPITAL ASSETS:			CAPITAL STOCK--Issued and	
Plant and Equipment		$180,000.00	Outstanding	$300,000.00
CURRENT ASSETS:			CURRENT LIABILITIES:	
Inventories	$97,100.00		Audited Vouchers	49,500.00
Customers' Accounts	56,500.00		SURPLUS:	
Cash	32,900.00	186,500.00	Profits for year	17,000.00
		$366,500.00		$366,500.00

COMPLETE ACCOUNTING COURSE--PART I

Lecture 29

ANSWERS TO GENERAL REVIEW QUESTIONS

Solution to General Review Problem 21

Exhibit A.

JONES LITHOGRAPHING CO.
BALANCE SHEET, DECEMBER 31, 1917

ASSETS

CURRENT ASSETS:				
Cash			$ 7,150.00	
Working Fund			1,000.00	
Accounts Receivable			54,300.00	
Due from Officers			10,100.00	
Inventories:				
Raw Materials			9,800.00	
Work in Progress			4,500.00	$ 86,850.00
DEFERRED CHARGES:				
Discount on Stock			$ 10,300.00	
Prepaid Commissions			8,140.00	
Inventory of Postage			500.00	
Prepaid Insurance			1,110.00	20,050.00
INVESTMENT IN X PRINTING CO.				350,000.00
CAPITAL ASSETS:	Cost	Reserve for Depreciation	Book Value	
Land	$ 45,000.00	$----------	$ 45,000.00	
Buildings	351,300.00	73,565.00	277,735.00	
Machinery	236,500.00	81,850.00	154,650.00	
Fixtures	166,000.00	62,400.00	103,600.00	
Total	$798,800.00	$217,815.00	$580,985.00	580,985.00
TOTAL ALL ASSETS				$1,037,885.00

LIABILITIES AND CAPITAL

CURRENT LIABILITIES:			
Accounts Payable		$ 6,000.00	
Notes Payable		2,000.00	
Bank Loan		10,000.00	
Accrued Bond Interest		8,000.00	
Accrued Taxes		1,907.30	$ 27,907.30
FIRST MORTGAGE 4% BONDS			400,000.00
SINKING FUND RESERVE			340,000.00
CAPITAL STOCK AND SURPLUS:			
Issued and Outstanding		$500,000.00	
Deficit, Jan. 1, 1917	$245,700.00		
Less--Surplus Net Profit for year (Exhibit B)	15,677.70	230,022.30	269,977.70
TOTAL LIABILITIES AND CAPITAL			$1,037,885.00

Exhibit B

JONES LITHOGRAPHING CO.
STATEMENT OF PROFITS AND INCOME
YEAR ENDING DECEMBER 31, 1917

SALES		$942,000.00
Less--Allowances on Sales		8,450.00
NET SALES		$933,550.00
COST OF GOODS SOLD (Exhibit C)		813,630.00
GROSS PROFIT FROM SALES		$119,920.00
DEDUCT--SELLING AND GENERAL EXPENSES:		
Selling Expenses (Exhibit D)	$ 37,330.00	
General and Administrative Expenses (Exhibit E)	30,512.30	67,842.30
NET PROFIT FROM OPERATIONS		$ 52,077.70
ADD--Dividend on X Printing Co. Stock		7,000.00
Total Profits and Income		$ 59,077.70
DEDUCT--Interest on Bonds	$ 16,000.00	
Discount on Sales	2,400.00	
Discount on Stock written off	5,000.00	23,400.00
SURPLUS NET PROFIT for year		$ 35,677.70
DEDUCT--Provision for Sinking Fund		20,000.00
BALANCE CARRIED TO SURPLUS ACCOUNT		$ 15,677.70

Exhibit C

JONES LITHOGRAPHING CO.
STATEMENT SHOWING COST OF SALES
YEAR ENDING DECEMBER 31, 1917

RAW MATERIAL USED		$573,150.00
DIRECT LABOR		125,000.00
FACTORY OVERHEAD:		
Manufacturing Supplies	$ 8,500.00	
Heat, Light, and Power	9,200.00	
Insurance	1,870.00	
Indirect Labor	11,000.00	
Sundry Manufacturing Expenses	14,150.00	
Property Taxes	945.00	
Depreciation	65,215.00	
Salary to W. R. Single	6,000.00	116,880.00
TOTAL MANUFACTURING COST		$815,030.00
DEDUCT--Increase of Inventory of Work in Progress:		
December 30, 1917	$ 4,500.00	
January 1, 1917	3,100.00	1,400.00
Cost of Product Sold (Exhibit B)		$813,630.00

Exhibit D

JONES LITHOGRAPHING CO.
SELLING EXPENSES
YEAR ENDING DECEMBER 31, 1917

Commissions to Salesmen	$ 33,330.00
Promotion Expense	4,000.00
TOTAL SELLING EXPENSES (Exhibit B)	$ 37,330.00

Exhibit E

JONES LITHOGRAPHING CO.
GENERAL AND ADMINISTRATIVE EXPENSES
YEAR ENDING DECEMBER 31, 1917

Salary--D. R. Jones	$ 12,000.00
General and Administrative Expense (unclassified)	15,300.00
Depreciation on Fixtures	900.00
Bad Debts	1,350.00
Income Tax and Capital Stock Tax	962.30
TOTAL GENERAL AND ADMINISTRATIVE EXPENSES (Exhibit B)	$ 30,512.30

ANSWERS TO GENERAL REVIEW QUESTIONS

Answer to Question 82--

1. From all available sources prepare a schedule of assets and liabilities at the end of the period for which the profit or loss is to be ascertained. The difference between the assets and liabilities is the net worth (if the assets exceed the liabilities) or the net insolvency (if the liabilities exceed the assets) at that date.

2. Prepare a similar statement as of the date the period under consideration begins, and the difference between the assets and liabilities will represent the net worth or net insolvency at that time.

3. The difference between the net worth at the beginning of the period and the net worth at the end of the period is caused by:

(a) Moneys invested or withdrawn by the proprietors.
(b) Profits made or losses incurred by the enterprise.

4. The following form presents the above facts:

(Name)
STATEMENT OF PROFITS
(Period covered)

Net Worth at end of the period	$-----
Net Worth at beginning of period	-----
Balance--being increase (or decrease) in net worth during period	$-----
Add--Drawings of proprietors during period	-----
	$-----
Deduct--Additional Capital contributed by proprietors during period	-----
Balance--Net Profit (or Loss) for the period	$-----

5. If no inventories of material on hand at beginning or end of the period have been taken, and if no reliable data as to the cost of such stock are available, the amount of profit or loss for that period cannot be determined. If, however, such data are available, especially at the beginning of the period, an analysis of the various records, by way of contracts, cash receipts and disbursements, sales and purchase records, etc., should produce statements which will substantially set forth the financial status at the end of the period. The important point to bear in mind is that unless the net worth at the beginning of the period under consideration is an ascertainable fact, the profit or loss for that period cannot be determined.

Answer to Question 83--A Trial Balance is a statement as of a certain date of all open accounts in a ledger kept by double entry, prepared after the books of a concern have been posted, showing in two parallel money columns either the total of the debit side and the total of the credit side of each ledger account, or the difference between the debit and credit sides of each ledger account. If the total debit column equals the total credit column, the trial balance is said to be "in balance."

A trial balance "before closing" contains all ledger accounts, real or nominal. A trial balance "after closing" contains only asset and liability accounts.

A Balance Sheet is the trial balance "after closing" with the assets, liabilities, and net worth so summarized as to set out clearly the financial condition of the concern at a particular moment of time. It may be in "statement" or "account" form.

Answer to Question 84--The purpose of grouping assets and liabilities according to their nature is to bring out clearly the relation of the capital investment to fixed property, the amount of assets available for liquidating current indebtedness, etc.

Answer to Question 85--Two ways of regarding capital and revenue expenditures may be given:

1. Capital expenditures are expenditures the benefit of which has not expired at the end of the fiscal period under consideration, while revenue expenditures are those the benefit of which has expired or will expire before the close of such fiscal period. Under this classification, capital expenditures would consist of the capital assets, current assets, and deferred charges existing at any one moment of time, this moment of time being commonly regarded as the date on which a balance sheet is prepared, i.e., at the close of a fiscal period. Revenue expenditures would consist of debit nominal accounts.

2. Capital expenditures are expenditures for more or less permanent fixtures of the business, evidenced on the balance sheet by what appears normally under the caption of "Capital Assets"; while revenue expenditures are the current expenditures of the business of whatsoever nature, excluding those made for permanent assets. Revenue expenditures would thus consist of material, labor, and other expenses, some of which might appear on the balance sheet under the headings of current assets and deferred charges, while the remainder would appear in profit and loss accounts.

The differences in the two viewpoints arise chiefly from the fact that in each case the time element is not the same. In the first instance a cross-section of the business is taken, presenting as capital that portion of expenditures made for the benefit of the future, whether "future" is considered as days or years. In the second instance, capital expenditures consist only of "aids in production"; that is, real estate, plant, machines, etc., whose usefulness extends to some indeterminable point in the future.

Answer to Question 86--Receipts and Disbursements are transactions involving the actual transfer of cash, whereas the terms Income and Expenditures refer to the entire revenue for any given period, either collected or still to be collected, and the total obligations incurred, whether paid or still owing. It would be noted here that the terms Expense and Expenditure do not carry the same meaning, in that the term expenditure is more comprehensive since it may involve the purchase of capital or fixed assets, as well as material for resale or other operating factors. If, however, payment has been made in settlement of either of such obligations, the transaction incident to payment thereof will constitute a disbursement. Whether the payment is made for a property asset or an expense item is immaterial. If the cash was actually paid out, it constitutes a disbursement.

Answer to Question 87--Goods out on consignment are the property of the consignor, under his control and subject to his orders. Therefore, the record of such consignment should not in any way be made to imply a sale or transfer of title to the consignee. The record should indicate clearly that the person charged is a consignee, not a customer; and the credit should not be made to the Sales account for the goods are still unsold.

Answer to Question 88--

CONSIGNMENTS-OUTWARD LEDGER CONTROLLING ACCOUNT

DEBIT WITH	CREDIT WITH
Invoice cost of consignments shipped, at the same time crediting Purchases.	Advances made by consignee, at the same time debiting Cash.
Freight-out, express, and other charges on shipment, at the same time crediting Cash or Accounts Payable.	Net proceeds reported by consignee, at the same time debiting Cash or Consignee's Personal account.
Profits on shipments, at the same time crediting Profits on Consignments-Outward or Profit and Loss.	

The balance of the account will be a debit, representing the cost (less advances) of consignments not yet closed out.

A journal is ordinarily provided for the first debit, postings to the controlling account being made monthly. In the detail or subsidiary ledger a separate account is kept with each consignment, and debit and credit postings are made to each account in the usual way. Separate columns for the controlling account should be provided in the cash receipts and disbursements books, voucher record, general journal, etc.

Answer to Question 89--

CONSIGNMENTS-INWARD LEDGER CONTROLLING ACCOUNT

DEBIT WITH	CREDIT WITH
Costs of Consignments-Inward paid by the consignee, such as freight, express, drayage, etc., at the same time crediting Cash.	Proceeds from sales of consignments, at the same time debiting Cash or customers' accounts.
Advances to consignor, at the same time crediting Cash.	
Profits on consignments as deducted on account sales, at the same time crediting Profits on Consignments-Inward or Profit and Loss.	

The balance of the account will be a credit or debit and will represent the excess of sales over advances on consignments not closed out or the excess of advances over sales. Since the balance is made up of debit and credit balances in the subsidiary ledger, it should be split for balance sheet purposes. The total of debit balances will appear as an asset and the total of credit balances as a liability.

Special columns should be provided in the books of original entry, including the sales book.

Answer to Question 90--A joint venture is a temporary combination of two or more individuals, firms, or corporations for the purpose of undertaking some particular transaction.

As the manager, A will keep account of the venture and will open up on his books an account with the venture, also accounts with each of the venturers. When B advances the merchandise, A will credit his account and debit the Venture account at the agreed price. As C collects the proceeds A will debit his account with C and credit the Venture account. All the proceeds having been accounted for, A will close the Venture account, crediting the personal accounts for the proper amount of the profits to be distributed. A will then send each venturer a statement of the venture, indicating the amount to be remitted by C to A and B.

Answer to Question 91--There are three methods which may be used for accruing interest on notes payable, viz.:

1. Make no entry until the interest is paid, at which time charge the payment to Interest Expense account. This method is very simple to apply but it is unsatisfactory because as a general rule the interest is not charged to the period incurring the expense.

2. Interest when paid is charged to Interest Expense. At the end of each fiscal period take up the accrued interest as follows--

-December 31-

Interest Expense	$-----	
To--Interest Accrued		$-----
To take up accrued interest at December 31.		

At the beginning of the next fiscal period reverse the entry as follows:

-January 1-

Interest Accrued	$-----	
To--Interest Expense		$-----
To reverse entry at December 31 taking up accrued interest at that date.		

The effect of this procedure is to charge each period with the amount of interest accruing during that period.

3. Under this plan it is assumed that all interest payments represent liquidation of liabilities already accrued. Consequently the liability is built up as follows:

(1)

Interest Expense	$-----	
To--Interest Accrued		$-----
To take up interest accruing during month of -------.		

(2)

Interest Accrued	-----	
To--Cash		-----
Interest on ------- paid.		

The balance in the Interest Accrued account is a current liability.

<u>Answer to Question 92</u>--The reason for omitting from merchandise inventory values the increase in market value over the cost price of the stock on hand is that to take up such increase when computing the results from operating would have the effect of including in any statement of earnings an amount of profit not yet realized. Profits are not realized from unsold goods. On the other hand, if the market value of goods in stock is less than the purchase price, then a loss has been sustained, in that such goods could be duplicated for less than they cost, and the same reasons which exclude from the statement of earnings any unrealized profits, also require that all losses should be taken into account within the period during which they occurred. Briefly, then, the rule for valuation of merchandise inventories is "cost or market, whichever is the lower." The accepted principle is that profits should not be anticipated and all probable losses should be provided for.

<u>Answer to Question 93</u>--

1. All receipts can be deposited and all disbursements made by check only.

2. Small items can be paid in currency and the total of such payments for a period represented by a check drawn to replenish the fund. Control over these payments is secured because the replenishing of the cash fund calls for an inspection of the petty payments to date by an executive, thus reducing to a minimum the opportunities for theft of cash by employees.

The amount of the fund will always be represented by receipts for disbursements or currency in the hands of the petty cashier.

Answer to Question 94--This method of handling cash sales affords a check on the amount of cash to be accounted for by the cashier from this source. The charge to cash sales as reported by the sales department must be equalled by the amount of cash received from cash sales as reported by the cashier. Any difference between these amounts will at once be apparent and the reason for such discrepancy should be immediately ascertained.

Answer to Question 95--The chief accounts found in a partnership but not in a corporation are:

1. DRAWING ACCOUNTS. A drawing account is kept with each partner and is charged with whatever withdrawals of cash or merchandise are made, and credited with salary and interest allowances and profits for the period. Sometimes interest is charged to the drawing account if the partnership agreement provides that penalty for withdrawals above a certain amount. The balance of the drawing account may be a debit or credit and is usually transferred at the end of a period to the capital account of the partner, representing the net decrease or increase of the investment of the partner during the period.

2. CAPITAL ACCOUNTS. Each partner has his own capital account which is credited with his original investment. At the end of each fiscal or accounting period, the drawing account is transferred to the capital account which then shows the book value of the partner's investment in the business on that date. As a rule no other entries are found in this account except those recording additions to or withdrawals of investment.

3. LOAN ACCOUNTS. Partners may advance amounts to their enterprise in the form of temporary loans rather than capital contributions. The account is handled like any note payable account and interest thereon may be charged to the Interest account and credited to the partner's drawing account.

Answer to Question 96--A corporation operates under the authority of a charter granted by the state under whose laws it is incorporated.

Answer to Question 97--Unissued stock consists of that part of the total authorized issue of capital shares which has not been issued to shareholders. They may or may not be subscribed for.

Treasury stock consists of shares issued and fully paid for, which subsequently are returned to the corporation by way of purchase, gift, or forfeiture, and not cancelled.

Unissued stock, or rather unsubscribed stock, does not represent anything of value, but is simply a means of obtaining value through sale and issuance, thus creating a liability equal to the value to be so acquired. Treasury stock, however, having been once issued and fully paid for and subsequently surrendered to the corporation, is an asset of the corporation because the amount of liability for the authorized issue is not affected in case such stock is again sold.

Answer to Question 98--When treasury stock (carried on the books at par) is sold for an amount less than par, the difference between the selling price and par value represents a discount allowed for the purpose of promoting the sale, and should be charged on the books to an account of that name (Discount Allowed on Treasury Stock). This account should ultimately be closed into Surplus account. The reasons for so disposing of the discount account are:

1. If the treasury shares were acquired through gratuitous donations to the corporation, the par value thereof increased the surplus or decreased the amount of the deficit. If this full par value is not realized it is necessary to revise the amount previously credited to the Surplus or Deficit account. If the credit is made to Capital Surplus when the stock is donated, the discount sustained should be charged to that account.

2. If, however, the treasury stock was acquired through purchase (at par), any amount less than par value which may have been accepted for such stock reduces the amount of any surplus which may then exist. If there be no surplus, then such discount would either create or increase the amount of deficit.

When treasury bonds (carried on the books at par value) are sold below par, the difference between par value and the selling price represents discount allowed to the purchaser, and should be charged to Discount Allowed on Treasury Bonds, and spread equitably over the life of the bonds. If the treasury bonds purchased are carried at cost, the amount received when sold may be credited to the purchase account and the difference would represent the profit or loss on the transaction.

Answer to Question 99--Bonds represent a liability for money borrowed, the repayment of which, together with interest, must be made within a definitely prescribed time, such repayment being ordinarily in no way contingent upon sufficiency of earnings, except in so far as the value of security for the bonds may be reduced by losses.

Capital stock, however, represents money or property contributed by way of investment in the enterprise (not loaned), ordinarily without provision for repayment during the life of the corporation. Payment of interest by way of dividends on capital stock, even though that stock be "preferred," may be controlled by the board of directors according to their judgment as to the sufficiency of the profits to justify a dividend payment.

In other words, the proceeds from capital, contributed by way of investment, are not subject to withdrawal during the ordinary course of the corporation's activity, whereas loans mature at predetermined dates and constitute a prior claim against available assets (either specific or general).

Answer to Question 100--Payment of interest and repayment of principal on the first-named class of bonds are secured by a mortgage on specific property, either real estate or chattels, which may be sold and the proceeds used to meet the amount of such indebtedness in the event of defaulted payments.

No specific property, however, is pledged as security for payment of either principal or interest in the case of income bonds. As the name would indicate, income bonds are merely contract obligations to provide out of the proceeds from net income a fund sufficient to redeem such bonds at maturity and to pay the interest thereon periodically before distributing any portion of such net income by way of dividends. In the event of dissolution, voluntary or otherwise, its holders have no preference over other general creditors.

Usually no specific property is pledged or mortgaged to secure payment of either principal or interest on municipal bonds. The security for bonds of this class lies in the power vested in the municipality to levy taxes and the right of bondholders to enforce the exercise of such power.

Answer to Question 101--Any proceeds from bond sales in excess of the amount for which the bonds must be redeemed represent a premium and should be credited to a Premium on Bonds account. Payment of premiums for bonds is prompted by the high rate of interest offered (security for principal considered), and therefore the total premium of $5,000 should be amortized over the life of the bonds.

Answer to Question 102--Surplus may accrue from several sources, viz.:

1. Profits from operations, withheld from distribution.
2. Donations of property or securities.
3. Sale of capital stock at premium.
4. Writing up the value of fixed assets.

Generally, however, any surplus which has accrued from any of the three last-named causes is not immediately available for dividend purposes, and should be stated separately in the accounts and designated "Capital Surplus."

Answer to Question 103--When dividends have been officially declared, the amount thereof should at once be charged to "Surplus" and credited to "Dividend Payable" account. This is essential even though the time for payment be long deferred. A dividend once declared by the board of directors assumes the nature of a direct liability, as between stockholder and corporation, payment of which can be enforced by the stockholders then of record; hence the accounts should be immediately made to show that a part of the surplus has been appropriated for ultimate payment of such dividend.

Answer to Question 104--When actual profits have been realized the directors of a corporation have the right to declare dividends equal to any part of such profits, whether they be represented by cash or by less liquid assets. The question as to borrowing funds so as to pay such dividends in cash is one of policy, and should be decided according to the judgment of those parties vested with authority for, and charged with the responsibility of, formulating the policy for financing the corporation's various activities and functions.

Answer to Question 105--A reserve for depreciation is necessary in spite of the reasons given, since the purpose of the reserve is to charge against the profits, period by period, the proper loss which that period should stand, a capital asset being eventually used up in operation in the same sense that current supplies are used up in operation, the difference being one of time only.

In answer to the two arguments presented, it may be said that operating efficiency has little to do with the reserve for depreciation that may be necessary. The operating efficiency may never fall below 70%, yet when it reaches that point the machine or plant may have to be scrapped, due to the fact that its operating cost is too high and its productive capacity too low for the purposes of the business.

Answer to Question 106--The point involved here relates to the question as to whether losses from bad debts should be charged against earnings of the period during which such debts were acquired or the earnings of the period during which such losses become apparent and actual. The former method is the more conservative of the two. And it is to anticipate such losses that a reserve is created by charging Profit and Loss account each period with the estimated amount of the accounts which in the course of liquidation may prove to be uncollectible. Hence, on the theory that the amount of such losses has been previously charged against profits, and assuming that the existing reserve is ample, the proper disposition of such uncollectible item is to charge same against the reserve account. The entry then is:

Reserve for Bad Debts	$--------	
To--Customers' Account		$--------

Answer to Question 107--A reserve set aside for the retirement of bonds is but a temporary device to indicate the portion of past earnings which must be kept intact, and not distributed until such bonds have been paid; whereas a reserve for depreciation represents the estimated portion of property and equipment cost which has entered directly into the expense of operating during previous periods.

The difference in the nature of these two classes of reserves may be readily seen from the ultimate disposition to be made of each on the books. A Reserve for Retirement of Bonds finally reverts to the Surplus account, but a Reserve for Depreciation goes to negative the book value of assets, the depreciation of which is provided for by such reserve.

Answer to Question 108--When such good-will has been acquired through purchase, as in the case of a firm, individual, or corporation buying the business of another and paying therefor an amount (either in cash or other property) over and above the appraised value of the net tangible assets.

An amount to represent good-will may also be properly recorded in the books of any enterprise when the value thereof has been realized through sale and converted into assets, the nature of which permits of their distribution among the owners of the net worth.

Ordinarily, however, it is not considered good practice to set up in the accounts of a going concern any amount to represent the value of its own good-will.

Answer to Question 109--When the average earnings of an enterprise exceed the ordinary return by way of interest on the capital investment (after due allowance is made for proprietor's services), such excess earnings denote the existence of an intrinsic or inherent value, quite apart from that value represented by the tangible property and other book assets directly employed in the production of those earnings.

Occasion often arises for determining and expressing, in terms of dollars and cents, the commercial worth of that inherent factor, as in the case of the sale of the enterprise, or when an interest is to be acquired in the business by parties other than those whose capital or influence is responsible for the existence of such value.

If net earnings of, say, $10,000 are made annually from a capital investment of $40,000, the percentage of profit is 25. If a fair normal return on capital is assumed to be 10%, then the normal earnings would be 10% on the $40,000 investment, or $4,000. The excess earnings of $6,000 would represent income from the good-will attaching to the business which may be valued at $60,000 as shown in the following illustration:

Total Earnings	$10,000.00
Deduct--Amount equal to normal interest return on capital investment at 10%	4,000.00
Excess Earnings	$ 6,000.00

If $6,000 represents 10% of the value by which that amount was produced, then 100%, or 10 x $6,000 = $60,000, would represent the entire value to be placed on that factor to which is attributed the earnings in excess of the normal rate of profit.

To capitalize these earnings at that value would involve setting up an account with "Good-will" (debit), and, correspondingly, crediting Surplus account. Then, if capital stock is to be issued on the strength of such value, the book entry would be:

Surplus	$--------	
To--Capital Stock		$--------

Answer to Question 110--A consolidated balance sheet does not, nor does it pretend to, represent the financial condition of any particular corporation; or in fact any legal entity whatsoever. It is a statement set up in conventional balance sheet form representing the true financial position of a group of companies which, from a practical point of view, are in reality one organization. In the preparation of such a statement all items affecting the companies *inter se* are eliminated, so as to present their financial position so far as the public is concerned.

Answer to Question 111--A perpetual inventory is kept for the purpose of ascertaining the cost of goods sold (trading concern) or of goods used in production (manufacturing). To this end appropriate records are kept which may consist simply of quantities received and quantities given out and balance on hand in each class of stock or of raw materials. In some businesses, for instance, a trading concern dealing in notions, the expense of keeping perpetual inventory records would be all out of proportion to the advantages derived. In other businesses the recording of goods sold by description may be a simple matter. The setting down of prices may be unnecessary and impracticable where purchases are made on fluctuating terms. The chief advantages to a manufacturing concern of keeping a perpetual inventory record are usually enumerated as follows:

1. To enable the determination of monthly profits without a physical count of the goods on hand. However, the amount per books is customarily verified at least once a year by taking a physical inventory.

2. To prevent fraud and to insure careful handling on the part of storekeeper who must account for the materials under his charge.

3. To assure "maximum" and "minimum" quantities necessary for the proper operation of the factory.

A controlling account is a condensed summary of all transactions posted in detail in a subsidiary ledger. This reduces the volume of work on the general ledger so that only the head bookkeeper is familiar with the results from operations. It can be balanced independently of the other ledgers, thus enabling the bookkeeper to prepare financial statements on short notice. It also enables the head bookkeeper to control the work of his assistants and by localizing errors to a particular ledger the labor of locating them is minimized.

From this description it is obvious that the general ledger accounts kept in connection with perpetual inventories are controlling accounts.

Answer to Question 112--

1. A fixed percentage applied on a flat basis. If an asset has a cost value of $2,000 and an estimated scrap value of $200, the difference of $1,800 must be charged off during the life of the asset. Assuming an estimated life of ten years, one-tenth of $1,800, or $180, must be written off annually. This is equivalent to 9% on the original cost, or 10% on the total depreciation to be provided for.

2. A fixed percentage applied on the diminishing value. Assuming the above facts, 20.57% must be charged off annually. A rate is ascertained which if applied on the original cost and on the diminished value thereof, annually will reduce the book value of the asset to its estimated scrap value at the end of its estimated life.

3. Production. The estimated quantity of production during the estimated life of the asset is divided by the cost of the asset less its residual value to determine the amount per unit of production to be provided. This method is limited to cases where the depreciation accruing is closely related to the volume of production.

Answer to Question 113--The voucher system as generally used at the present time comprises:

1. Voucher
2. Check or voucher check
3. Voucher register
4. No creditors' accounts
5. Index to vouchers

Under the voucher system no disbursement can be made until a voucher is prepared. This voucher contains all the details of the transaction, shows the distribution of charges and credits, and bears the approvals referred to in answer to Question 114. Vouchers are kept in "Unpaid Vouchers" file until ready for payment.

A voucher may be paid by ordinary bank check or by voucher check. The latter consists of an ordinary bank check form together with a summary of the details shown on the voucher. Sometimes a voucher proper is not kept, the voucher check containing all details and serving as a voucher until issued. In the latter case it bears two serial numbers: first the voucher series, and secondly the cash book series.

The voucher register is a journal containing all the necessary columns to distribute properly the charges and credits indicated on the voucher. Usually credit columns appear for "Audited Vouchers" (controlling account) and "Discount on Purchases," and a debit column for each numerous class of charges with one column for miscellaneous charges. Postings made monthly. The miscellaneous column is posted in detail but only the footing of each special column need be posted. In addition columns are provided for voucher number, party to whom issued, date paid or check number by which paid.

An account with each individual creditor need not be kept, although this is often done. If individual accounts are not kept an index is essential. A card is prepared for each creditor showing the number of each voucher issued to him and the amount thereof. By this means all vouchers relating to an account can be assembled when necessary. Oftentimes an additional copy of the voucher is made, to be filed alphabetically and thus serve as the index. The unpaid vouchers constitute the current accounts payable.

The voucher system is best adapted to those concerns which pay their invoices in full when due, and where frequent reference to creditors' accounts is not required. But where payments are continually made on account, or where constant reference to the creditor's account is a necessity, the advantage lies in keeping a ledger account with each creditor. In some cases creditors' accounts are divided, one part kept on the first-mentioned basis and the others on the latter basis.

Answer to Question 114--

(a) The O. K. of the receiving clerk or stock clerk as to receipt of goods of proper quality.

(b) The O. K. of the purchasing agent that the goods are as ordered and that the terms are correct as to dating, discount, freight, etc.

(c) That the extensions and footings of the invoice are correct.

The head of the accounting department approves the voucher as a whole, and the general manager or other authorized official approves the payment thereof.

COMPLETE ACCOUNTING COURSE--PART I

Lecture 30

GENERAL REVIEW

Solution to Assignment I-28-1

ENTRIES TO CLOSE THE BOOKS OF THE
MILLER MOTOR CAR CO., JUNE 30, 19--

(1)		
Depreciation (Manufacturing)	$ 116.67	
To--Reserve for Depreciation of Buildings		$ 116.67
Provision for month of June at 2% per annum.		
(2)		
Depreciation (Manufacturing)	1,380.03	
To--Reserve for Depreciation of Machinery		1,380.03
Provision for month of June at 10% per annum.		
(3)		
Depreciation of Delivery Equipment	21.88	
To--Reserve for Depreciation of Delivery Equipment		21.88
Provision for month of June at 15% per annum.		
(4)		
Depreciation of Office and Warehouse Fixtures	10.23	
To--Reserve for Depreciation of Office and Warehouse Fixtures		10.23
Provision for month of June at 6% per annum.		
(5)		
Bad Debts	1,449.63	
To--Reserve for Bad Debts		1,449.63
½% of gross sales for June.		
(6)		
Taxes	285.67	
To--Taxes Accrued		285.67
Taxes accrued during June.		

(7)

Bond Interest	$ 1,000.00	
To--Bond Interest Accrued		$ 1,000.00
Accrued during June, viz.: 5% Bonds $625; 6% Bonds $375; total $1,000.		

(8)

Miscellaneous Selling Expenses	50.00	
To--Rent Paid in Advance		50.00
Rent expired.		

(9)

Insurance	76.67	
To--Unexpired Insurance		76.67
Insurance expired.		

(10)

Interest Accrued on Notes Receivable	315.92	
To--Interest Received		315.92
Interest accrued but not due.		

(11)

Interest Paid	200.00	
To--Interest Prepaid		200.00
To write off prepaid interest on bank loan.		

(12)

Discount on Sales of Finished Parts	1,800.00	
To--Reserve for Discounts		1,800.00
Reserve for discounts to be taken by customers.		

(13)

Inventory of Miscellaneous Supplies	3,600.00	
To--Heat, Light, and Power		3,500.00
Stationery and Printing		100.00
Inventory of supplies on hand at June 30.		

(14)

Inventory of Raw Materials	16,767.44	
To--Purchases Raw Materials		16,767.44
To close latter account.		

(15)

Work in Progress	18,897.04	
To--Inventory of Raw Materials		18,897.04
Raw materials requisitioned during June.		

(16)

Inventory of Finished Parts	$66,523.13	
To--Purchases Finished Parts		$66,523.13
To close latter account.		

(17)

Work in Progress	45,109.16	
Cost of sales--Finished Parts	25,724.33	
To--Inventory of Finished Parts		70,833.49
Finished parts requisitioned during June.		

(18)

Work in Progress	73,141.13	
To--Direct Labor		39,901.98
Indirect Labor		21,171.14
Heat, Light, and Power		5,459.75
Repairs--Plant and Equipment		3,309.60
Royalties		600.00
Shop Supplies		683.85
Depreciation		1,496.70
Insurance		76.67
Taxes		285.67
Miscellaneous Factory Expense		155.77
To close manufacturing accounts.		

(19)

Inventory of Automobiles	142,725.39	
To--Work in Progress		142,725.39
To transfer cost of cars made during June.		

(20)

Cost of Sales--Automobiles	175,543.64	
To--Inventory of Automobiles		175,543.64
To transfer cost of cars sold during June.		

(21)

Sales--Automobiles	235,385.00	
To--Automobile Trading Account		235,385.00
To close Sales account.		

(22)

Automobile Trading Account	177,397.64	
To--Allowance on Sales--Automobiles		1,854.00
Cost of Sales--Automobiles		175,543.64
To close accounts.		

(23)

Sales--Finished Parts	39,191.08	
To--Finished Parts Trading Account		39,191.08
To close Sales account.		

(24)

Finished Parts Trading Account	$32,767.59	
To--Allowances on Sales--Finished Parts		$ 2,052.75
Discount on Sales--Finished Parts		4,990.51
Cost of Sales--Finished Parts		25,724.33
To close latter accounts.		

(25)

Automobile Trading Account	57,987.36	
Finished Parts Trading Account	6,423.49	
To--Profit and Loss Account		64,410.85
To transfer gross profit.		

(26)

Profit and Loss Account	33,309.12	
To--Salesmen's Salaries		6,491.00
Salesmen's Traveling Expenses		837.00
Advertising		25,647.25
Delivery Equipment Maintenance		108.54
Delivery Equipment Depreciation		21.88
Miscellaneous Selling Expenses		203.45
To close selling expense accounts.		

(27)

Profit and Loss Account	5,881.86	
To--Officers' Salaries		2,500.00
Office Salaries		1,328.25
Stationery and Printing		593.75
Depreciation of O. & W. Fixtures		10.23
Bad Debts		1,449.63
To close general administrative expense accounts.		

(28)

Discounts on Purchases	1,129.82	
Interest Received	717.43	
To--Profit and Loss Account		1,847.25
To close miscellaneous income accounts.		

(29)

Profit and Loss Account	1,222.94	
To--Interest Paid		222.94
Bond Interest		1,000.00
To close latter accounts.		

(30)

Profit and Loss Account	25,844.19	
To--Surplus		25,844.19
To transfer surplus net profits for June.		

Exhibit A

MILLER MOTOR CAR CO.
BALANCE SHEET, JUNE 30, 19--

ASSETS

CAPITAL ASSETS:	COST	RESERVE FOR DEPRECIATION	PRESENT VALUE	
Land	$ 40,000.00	$----------	$ 40,000.00	
Buildings	70,000.00	200.00	69,800.00	
Machinery, Tools, and Equipment	165,603.50	2,213.36	163,390.14	
Office and Warehouse Fixtures	2,045.00	17,48	2,027.52	
Delivery Equipment	1,750.00	43.76	1,706.24	
	$279,398.50	$ 2,474.60	$276,923.90	
Good-will			66,000.00	$342,923.90
INVESTMENT IN DURANT TRUCK CO.				200,000.00
CURRENT ASSETS:				
Inventories:				
Automobiles		$ 30,550.00		
Finished Parts		18,463.72		
Work in Progress		26,132.11		
Raw Materials		3,740.80		
Coal		3,500.00		
Stationery and Printing		100.00	$ 82,486.63	
Accounts and Notes Receivable:				
Customers' Accounts		$104,013.40		
Notes Receivable		116,003.00		
Accrued Interest on Notes Receivable		315.92		
		$220,332.32		
Deduct--Reserves for:				
Bad Debts	$1,522.75			
Discounts	1,800.00	3,322.75	217,009.57	
CASH:				
Cash in Bank		$ 50,186.45		
Petty Cash Fund		500.00	50,686.45	350,182.65
DEFERRED CHARGES:				
Advances to Salesmen			$ 2,000.00	
Unexpired Insurance			766.66	
Rent Paid in Advance			100.00	
Discount on Stock			2,000.00	4,866.66
TOTAL ASSETS				$897,973.21

LIABILITIES

CAPITAL STOCK:			
7% Preferred--Authorized and Issued (1,000 shares, par value $100 each)		$100,000.00	
Common--Authorized (5,000 shares, par value $100 each)	$500,000.00		
Issued and Outstanding		433,900.00	$533,900.00
BONDED INDEBTEDNESS:			
5% First Mortgage Bonds		$150,000.00	
6% First Mortgage Bonds		75,000.00	225,000.00
CURRENT LIABILITIES:			
Audited Vouchers		$ 60,144.12	
Accrued Liabilities:			
Pay-roll	$ 41,649.55		
Bond Interest	4,625.00		
Taxes	2,295.34	48,569.89	108,714.01
SURPLUS:			
Balance, June 1		$ 7,265.02	
Add--Profits for June (as per Exhibit B)		25,844.18	
		$ 33,109.20	
Deduct--Dividends Declared and Paid			
Preferred Stock 1.75%	$ 1,750.00		
Common Stock 1.00%	1,000.00	2,750.00	30,359.20
			$897,973.21

MILLER MOTOR CAR CO.
STATEMENT OF PROFITS AND INCOME
MONTH ENDING JUNE 30, 19--

	AUTOMOBILES	FINISHED PARTS	TOGETHER
GROSS SALES	$235,385.00	$39,191.08	$274,576.08
DEDUCT--Allowances	$ 1,854.00	$ 2,052.75	$ 3,906.75
Discount on Sales	----------	4,990.51	4,990.51
	$ 1,854.00	$ 7,043.26	$ 8,897.26
NET SALES	$233,531.00	$32,147.82	$265,678.82
DEDUCT--Cost of Sales (Exhibit C and D)	175,543.64	25,724.33	201,267.97
GROSS PROFIT ON SALES	$ 57,987.36	$ 6,423.49	$ 64,410.85
DEDUCT--SELLING AND GENERAL EXPENSES:			
Selling Expenses (Exhibit E)		$33,309.12	
General and Administrative Expenses (Exhibit F)		5,881.86	$ 39,190.98
NET PROFITS FROM OPERATIONS			$ 25,219.87
ADD--MISCELLANEOUS INCOME:			
Discount on Purchases		$ 1,129.82	
Interest Received		717.43	1,847.25
			$ 27,067.12
DEDUCT--INTEREST CHARGES:			
Bond Interest		$ 1,000.00	
Other Interest Paid		222.94	1,222.94
SURPLUS NET PROFITS (carried to Exhibit A)			$ 25,844.18

Exhibit C

MILLER MOTOR CAR CO.
STATEMENT SHOWING COST OF AUTO SALES
MONTH ENDING JUNE 30, 19--

MATERIALS:			
Raw Materials:			
Inventory, June 1	$ 5,870.40		
Purchases	16,767.44		
	$22,637.84		
Less--Inventory, June 30	3,740.80	$18,897.04	
Finished Parts		45,109.16	$ 64,006.20
DIRECT LABOR			39,901.98
FACTORY EXPENSES:			
Indirect Labor		$21,171.14	
Heat, Light, and Power		5,459.75	
Repairs--Plant and Equipment		3,309.60	
Royalties		600.00	
Shop Supplies		683.85	
Depreciation		1,496.70	
Insurance		76.67	
Taxes		285.67	
Miscellaneous Factory Expenses		155.77	33,239.15
TOTAL MANUFACTURING COST			$137,147.33
ADD--Decrease in Inventory of Work in Progress:			
Inventory, June 1		$31,710.17	
Inventory, June 30		26,132.11	5,578.06
COST OF AUTOMOBILES MANUFACTURED			$142,725.39
ADD--Decrease in Inventory of Automobiles:			
Inventory, June 1		$63,368.25	
Inventory, June 30		30,550.00	32,818.25
COST OF AUTOMOBILES SOLD (carried to Exhibit B)			$175,543.64

Exhibit D

MILLER MOTOR CAR CO.
COST OF FINISHED PARTS SOLD
MONTH ENDING JUNE 30, 19--

INVENTORY, June 1		$22,774.08
ADD--Purchases		66,523.13
		$89,297.21
DEDUCT--Finished Parts Used in Production	$45,109.16	
Inventory, June 30	18,463.72	63,572.88
COST OF FINISHED PARTS SOLD (carried to Exhibit B)		$25,724.33

Exhibit E

MILLER MOTOR CAR CO.
SELLING EXPENSES
MONTH ENDING JUNE 30, 19--

Salesmen's Salaries	$ 6,491.00
Salesmen's Traveling Expenses	837.00
Advertising	25,647.25
Delivery Equipment Maintenance	108.54
Delivery Equipment Depreciation	21.88
Miscellaneous Selling Expenses	203.45
TOTAL SELLING EXPENSES (Exhibit B)	$33,309.12

Exhibit F

MILLER MOTOR CAR CO.
GENERAL AND ADMINISTRATIVE EXPENSES
MONTH ENDING JUNE 30, 19--

Officers' Salaries	$ 2,500.00
Office Salaries	1,328.25
Stationery and Printing	593.75
Bad Debts	1,449.63
Depreciation of Office and Warehouse Fixtures	10.23
TOTAL GENERAL ADMINISTRATIVE EXPENSES (Exhibit B)	$ 5,881.86

FORMS FOR COMPLETE ACCOUNTING COURSE

Andersen

PART I

This package contains the following:

2	sheets	Form 1	Day Book
4	"	Form 2	Journal
7	"	Form 3	Record of Journal Entries
12	"	Form 4	" " " "
3	"	Form 5	Record of sales
2	"	Form 6	Record of Returned Sales
2	"	Form 7	Record of Purchases
6	"	Form 8	Record of Audited Vouchers
6	"	Form 8a	Manufacturing Expenses
4	"	Form 9	Cash Disbursements
6	"	Form 10	" "
3	"	Form 11	Record of Cash Receipts
2	"	Form 12	" " Checks Drawn
9	"	Form 13	Ledger one account to the page
12	"	Form 14	" two accounts to the page
36	"	Form 15	" three accounts to the page

Day Book

Form I

Day Book

Form 1

Day Book

Form 1

Journal

Form 2

Journal

Form 3

Journal

Form 2

Journal

Form 2

Journal

Form 2

Form 2

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form 3

editors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Credit[illegible] Ledg[illegible]

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form 3

editors edger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

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Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Cred Led

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Form

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Credit Ledg

Record of Journal Entries

Form 3

Creditors Ledger	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Creditors Ledger

Record of Journal Entries

Fo

Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audit Vouch

Form 4

udited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audi Vouc

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Record of Journal Entries

Form 4

udited uchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

For

Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audit Vouch

Record of Journal Entries

Form 4

udited uchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audi Vouc

Record of Journal Entries

Form 4

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Record of Journal Entries

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Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audite Vouche

Record of Journal Entries

Form 4

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Record of Journal Entries

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Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audite Vouche

Record of Journal Entries

Form 4

udited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

For

Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audit Vouch

Record of Journal Entries

Form 4

udited uchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

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Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audite Vouche

Record of Journal Entries

Form 4

udited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

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Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

Form 4

...dited ...uchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

For

Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audit Vouch

Record of Journal Entries

Form 4

...dited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Record of Journal Entries

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Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audit Vouch

Record of Journal Entries

Form 4

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Record of Journal Entries

For

Audited Vouchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audit Vouch

Record of Journal Entries

Form 4

udited uchers	Customers Ledger	General Ledger	Folio	Particulars	Folio	General Ledger	Customers Ledger	Audited Vouchers

Form

ate	Invoice No.	Name	Terms	Folio	Amount	Distribution of Sales	
						Automobiles	Accesso and Sup

Record of Sales

Form 5

nvoice No.	Name	Terms	Folio	Amount	Distribution of Sales	
					Automobiles	Accessories and Supplies

Record of Sales

Form

...te	Invoice No.	Name	Terms	Folio	Amount	Distribution of Sales	
						Automobiles	Accesso... and Supp...

Record of Sales

Form 5

nvoice No.	Name	Terms	Folio	Amount	Distribution of Sales	
					Automobiles	Accessories and Supplies

Record of Sales

Form

ate	Invoice No.	Name	Terms	Folio	Amount	Distribution of Sales	
						Automobiles	Accesso and Supp

Record of Sales

Form 5

Invoice No.	Name	Terms	Folio	Amount	Distribution of Sales	
					Automobiles	Accessories and Supplies

Record of Returned Sales Month of 19

Date	Invoice No.	Name	Terms	Folio	Amount	Distribution of Sal… Automobiles	Acces… and Su…

Record of Returned Sales Month of 19

Form 6

voice No.	Name	Terms	Folio	Amount	Distribution of Sales	
					Automobiles	Accessories and Supplies

Record of Returned Sales Month of 19

Date	Invoice No.	Name	Terms	Folio	Amount	Distribution of Sale[s]	
						Automobiles	Access[ories] and Su[pplies]

Record of Returned Sales Month of 19

Form 6

voice No.	Name	Terms	Folio	Amount	Distribution of Sales	
					Automobiles	Accessories and Supplies

Record of Purchases Month of 19

Date	Invoice No.	Name	Terms	Folio	Amount	Distribution of Sale	
						Automobiles	Access and Su

Record of Purchases Month of 19

Form 7

Invoice No.	Name	Terms	Folio	Amount	Distribution of Sales: Automobiles	Distribution of Sales: Accessories and Supplies

Record of Purchases Month of 19

Date	Invoice No.	Name	Terms	Folio	Amount	Distribution of Sale[s]	
						Automobiles	Access[ories] and Su[pplies]

Record of Purchases Month of 19

Form 7

Invoice No.	Name	Terms	Folio	Amount	Distribution of Sales: Automobiles	Distribution of Sales: Accessories and Supplies

Record of Audited Vouchers   Month of   19   Sheet No.   F

SELLING EXPENSES				GENERAL EXPENSES			SUNDRY ACCOUNTS		
Salesmen's Expenses	Traveling Expenses	Advertising	Misc. Expenses	Office Salaries	Stationery & Printing	Miscellaneous	Account	Folio	Am

Record of Audited Vouchers Month of 19

Form 8

her .	Date	Name	Detail	Check No.	Amount	Discount on Purchases	Distribution of Purchases Raw Materials	Finished Parts

Record of Audited Vouchers Month of 19 Sheet No.

SELLING EXPENSES				GENERAL EXPENSES			SUNDRY ACCOUNTS		
Salesmen's Expenses	Traveling Expenses	Advertising	Misc. Expenses	Office Salaries	Stationery & Printing	Miscellaneous	Account	Folio	Amo

Record of Audited Vouchers Month of 19

Form 8

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							Raw Materials	Finished Parts

Record of Audited Vouchers Month of 19 Sheet No.

Fo

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Record of Audited Vouchers   Month of   19

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Record of Audited Vouchers Month of 19 Sheet No.

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Record of Audited Vouchers Month of 19

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Record of Audited Vouchers Month of 19

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Record of Audited Vouchers Month of 19 Sheet No.

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Record of Audited Vouchers Month of 19

Form 8

her .	Date	Name	Detail	Check No.	Amount	Discount on Purchases	Distribution of Purchases	
							Raw Materials	Finished Parts

Form 8a

LABOR	
Direct	Indirect

bursements

Form

Date	Name	Detail		Repairs Plant Equip.	Heat, Light and Power	Shop Supplies	Miscellaneous
				MANUFACTURING EXPENSES			

Cash Disbursements

Form

Cash Disbursements

Form 9

Cash Disbursements

Form

Form 9

Cash Disbursements

Form

Cash Disbursements

Form 9

Cash Disbursements

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Cash Disbursements

Form 9

Cash Disbursements Month of 19

Form

Date	Account	Particulars	Check No.	Folio	General Ledger	Creditors Ledger	Discount on Purchases	Bar Withdr

Cash Receipts Month of 19

Form 10

te	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposits

Cash Disbursements Month of 19

Form

Date	Account	Particulars	Check No.	Folio	General Ledger	Creditors Ledger	Discount on Purchases	Bar Withdr

Cash Receipts Month of 19

Form 10

te	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposits

Cash Disbursements Month of 19

Form

Date	Account	Particulars	Check No.	Folio	General Ledger	Creditors Ledger	Discount on Purchases	Bar Withdr

Cash Receipts Month of 19

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Cash Disbursements Month of 19

Form

Date	Account	Particulars	Check No.	Folio	General Ledger	Creditors Ledger	Discount on Purchases	Ba[r] Withdr

Cash Receipts Month of 19

Form 10

te	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposits

Cash Disbursements Month of 19

Form

Date	Account	Particulars	Check No.	Folio	General Ledger	Creditors Ledger	Discount on Purchases	Ban Withdra

Cash Receipts Month of 19

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Cash Disbursements Month of 19

Form

Date	Account	Particulars	Check No.	Folio	General Ledger	Creditors Ledger	Discount on Purchases	Ban[k] Withdra[wals]

Cash Receipts Month of 19

Form 10

te	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposits

Record of Cash Receipts Month of 19

For

Date	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposi

Record of Cash Receipts Month of 19

Form 1

te	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposits

Record of Cash Receipts Month of 19

Date	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	For... Bank Deposi...

Record of Cash Receipts Month of 19

Form 1

[partial header]	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposits

Record of Cash Receipts Month of 19

Date	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Depos…

Record of Cash Receipts Month of 19

Form 1

e	Account	Particulars	Folio	General Ledger	Customers Ledger	Discount on Sales	Bank Deposits

Record of Checks Drawn Month of

Fo

Date	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount

Record of Checks Drawn Month of

Form

ate	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount

Record of Checks Drawn Month of

Fo

Date	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount

Record of Checks Drawn Month of

Form 1

ate	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount	Date	Voucher No.	Check No.	Amount

COMPLETE ACCOUNTING COURSE--PART II

By

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THE RONALD PRESS COMPANY

1920

COMPLETE ACCOUNTING COURSE--PART II

CONTENTS

COMPLETE ACCOUNTING COURSE--PART II

Lecture 1

STATEMENT OF AFFAIRS

Problem 1 (For Class Work)

The firm of A & B suspend payment, and the following particulars are obtained from their books as of December 31, 1918:

ASSETS

	Book Value	Expected to Realize
Real Estate	$ 33,000.00	$ 30,000.00
Buildings	96,000.00	60,000.00
Machinery and Equipment	82,800.00	78,000.00
Tools and Fixtures	13,250.00	9,000.00
Inventories	95,250.00	85,000.00
Customers' Accounts	94,100.00	85,000.00
Cash	3,175.00	3,175.00
	$417,575.00	$350,175.00

LIABILITIES

	Balance at Jan. 1, 1918	Loss for Year	
Mortgage obligation on Real Estate, Buildings, Machinery, Equipment, etc.			$125,000.00
Bills Payable			145,000.00
Trade Creditors			95,000.00
Partners' Capital Accounts:			
A	$ 80,000.00	$38,712.50	
B	50,000.00	38,712.50	
	$130,000.00	$77,425.00	52,575.00
			$417,575.00

Each partner's drawings for the year amounted to $10,000, which were paid in cash and absorbed in the expenses of doing business.

Prepare:
- (a) Statement of affairs
- (b) Deficiency account

Problem 2

August Miller, of the firm of Miller Brothers, indorsed notes of Fred Bentley to the amount of $6,000. Through the failure of Mr. Bentley to pay the same when due, August Miller was called upon to meet the notes and was unable to do so. A meeting of the creditors was called to determine whether further credit should be extended, or the business liquidated. They requested that a statement of affairs be prepared showing the status of the business as a liquidating concern.

The following balances were abstracted from the books of Miller Brothers, as of April 30, 1918: Delivery Equipment, $1,750; Warehouse and Office Fixtures, $1,450; Inventories--Merchandise, $39,090, Miscellaneous Supplies, $300; Advances on Consignments-Inward, $1,100; Customers' Accounts, $35,542; Notes Receivable, $10,100; Cash in Bank, $3,676.84; Petty Cash Fund, $100; Unexpired Insurance, $50; Rent Paid in Advance, $200; Notes Payable, $10,000; Accounts Payable, $36,080; Notes Receivable Discounted, $10,000; Bank Loan, $3,000; Taxes Accrued, $200; Fred Miller--Capital, $17,625.23; August Miller--Capital, $16,417.61; Interest Accrued on Notes Payable, $36.

In going over these accounts the partners decided that the delivery equipment would bring $1,200, and the fixtures $625; that the inventory of merchandise, while in good condition, would realize but $25,000 on forced sale, and miscellaneous supplies, $100. Of the customers' accounts, $17,500 were good; $11,800 were doubtful but would realize 50%; $6,242 were bad. Of the notes receivable, $10,000 were good; $100 were bad; advances on consignments-inward, $1,000; $173 was due for wages.

From the above information prepare a statement of affairs and a deficiency account.

Problem 3

The following trial balance was abstracted from the books of the firm of D & E as of June 30, 1919.

D--Capital Account		$ 32,113.29
E-- " "		17,803.92
D--Drawing Account	$ 2,500.00	
E-- " "	2,100.00	
Real Estate and Buildings	3,700.00	
Machinery and Fixtures	10,011.93	
Office Furniture	990.62	
Merchandise on hand January 1, 1919	19,032.27	
Merchandise Account	88,090.58	
Freight on Purchases	3,111.32	
Wages	8,111.03	
Power, Light, and Heat	1,100.50	
Miscellaneous Factory Expenses	3,400.03	
Insurance	900.00	
Discounts Received on Purchases		1,301.03
Sales Account		120,032.03
Discounts Allowed on Sales	2,100.75	
Freight Allowances on Sales	2,925.09	

Office Rent	900.00	
Traveling Expenses	1,425.50	
Advertising	1,783.03	
Bad Debts Written Off	854.83	
Sundry Office Expenses	1,103.92	
Office Salaries	4,004.50	
Interest Paid on Bills Payable	1,403.27	
Inventory of Finished Product (at January 1, 1919)	9,803.27	
Interest Received on Bills Receivable		442.37
Trade Creditors		19,803.04
Bills Receivable	9,800.00	
Customers' Accounts	24,093.27	
Bills Payable		10,000.00
Rents Collected		900.00
Accrued Interest and Taxes to June 30, 1919		1,100.03
Taxes	250.00	
	$203,495.71	$203,495.71

Under the partnership agreement, the following salaries were allowed: D, $2,700; E, $2,100.

The partners' capital accounts (calculated on the beginning balances) should be credited with interest at the rate of 6% per annum; no interest is chargeable on the withdrawals during the year. The inventory of finished products on hand at June 30, 1919, was valued upon the basis of the approximate cost of $20,103.98, against the selling value of $27,093.87. The inventory of raw material was also valued at cost and totaled $16,103.78.

Prepare:

(a) The journal entries necessary to close the books at June 30, 1919.

(b) Balance sheet at June 30, 1919, with relative manufacturing, trading, and profit and loss accounts.

MISCELLANEOUS QUESTIONS

Question 1--In case you find a surplus to creditors in preparing a statement of affairs for a corporation, how would you arrange the last section of this statement (not the deficiency account), where otherwise the details of the deficiency to stockholders would be summarized? In your answer draw up a form for this section which you would follow.

Question 2--The M S Co. suffers a large loss by fire (several buildings and considerable merchandise) only partially covered by insurance. There will be additional losses if liquidation takes place. Draw up skeleton deficiency account which you would expect to find in such a case.

Question 3--A small trading corporation doing an exclusively cash business has as its only book of account a columnar cash book. Columns are provided on the receipts side for Sales Department A, Sales Department B, Return Purchases, Miscellaneous, and First National Bank; and on the disbursements side

for Rent, Light, Postage, Salaries, Miscellaneous Store Expense, Purchases Department A, Purchases Department B, Discounts on Purchases, Return Sales, Miscellaneous, Check Number, and First National Bank. Receipts are deposited intact, sales being recorded in total each day from cash register footings. A petty cash fund serves the twofold purpose of supplying change and paying small bills; it is reimbursed each week by check. There are no accounts receivable or payable, no notes, and no capital assets.

Discuss:

(a) The question as to the adequacy of the records.

(b) Whether profit and loss statements and balance sheets may be properly prepared from such a record.

(c) Whether a single- or double-entry system of bookkeeping is being followed.

Question 4--In what order should the accounts in a general ledger be arranged?

Question 5--Distinguish between (a) a statement of receipts and disbursements and (b) a statement of income and expenditure.

Solution to Problem 1

A & B PARTNERSHIP
STATEMENT OF AFFAIRS
DECEMBER 31, 1918

Book Value	ASSETS	Expected to Realize	Gross Liabilities	LIABILITIES	Expected to Rank
	CURRENT ASSETS:				
$ 3,175	Cash	$ 3,175	$125,000	FULLY SECURED CREDITORS:	
94,100	Customers' Accts.	85,000		Mortgage Obligation	
95,250	Inventories	85,000		(deducted per contra)	
$192,525		$173,175			
	PROPERTY ASSETS:			UNSECURED CREDITORS:	
$ 33,000	Real Estate	$ 30,000	145,000	Bills Payable	$145,000
96,000	Buildings	60,000	95,000	Trade Creditors	95,000
82,800	Machy. & Equip.	78,000			
13,250	Tools & Fixtures	9,000			
		$177,000			
	LESS--Mortgage Obligation thereagainst	125,000			
$225,050		$ 52,000			
$417,575	Total, All Assets	$225,175	$365,000	Total Liabilities	$240,000
	Deficiency to Creditors--carried down	14,825			
		$240,000			$240,000
	Deficiency to Partners	$ 67,400		Deficiency to Creditors--brought down	$ 14,825
			52,575	Partners' Capital Accounts	52,575
$417,575		$67,400	$417,575		$ 67,400

A & B PARTNERSHIP
DEFICIENCY ACCOUNT
DECEMBER 31, 1918

Loss from operations for the year ending December 31, 1918 (exclusive of partners' salaries)		$57,425	Capital Investment of A & B at January 1, 1918	$130,000
Partners' drawings in respect of salary for the year ending December 31, 1918		20,000	Balance--Deficiency as per statement of affairs	14,825
Loss over book value on the realization of assets:				
Customers' Accts.	$ 9,100			
Inventories	10,250			
Real Estate	3,000			
Buildings	36,000			
Machy. & Equip.	4,800			
Tools & Fixtures	4,250	67,400		
		$144,825		$144,825

FORM OF STATEMENT OF AFFAIRS

Book Value	ASSETS		Expected to Realize
	CURRENT ASSETS:		
$----	Cash		$----
----	Customers' Accts:		
	Good	$----	----
	Doubtful (50%)	----	----
	Bad	----	
		$----	
----	Notes Receivable:		
	Good	$----	----
	Doubtful (50%)	----	----
	Bad	----	
		$----	
----	Insurance Unexpired		----
----	Inventories (less stocks held by partially secured creditors)		----
$----	Total Current Assets		$----
	CAPITAL ASSETS:		
$----	Land		$----
----	Buildings		----
----	Machinery and Tools		----
----	Other Equipment		----
			$----
	DEDUCT--Fully Secured Creditors (per contra)		----
$----	Total Capital Assets		$----
$----	Total, All Assets		$----
	DEDUCT--Preferred Creditors (per contra)		----
	Assets available for division among Creditors subject to Realization and Liquidation Expenses		$----
	Balance--Deficiency to Creditors carried down		----
			$----
	Deficiency to Proprietors		$----
$----			$----

Gross Liabilities	LIABILITIES		Expected to Rank
	PREFERRED CREDITORS:		
$----	For Taxes	$----	$----
	" Wages	----	
	Deducted, per contra	$----	
----	FULLY SECURED CREDITORS: (deducted--per contra)		
	PARTIALLY SECURED CREDITORS:		
----	Amount of Liability	$----	
	DEDUCT--Security thereagainst (per contra)	----	
	UNSECURED CREDITORS:		
----	Ordinary Trade Accounts	$----	
----	Notes Payable	----	
----	Sundry Accts.	----	----
$----	Total Liabilities		$----
			$----
	Deficiency to Creditors brought down		$----
----	Capital Accounts		----
$----			$----

DEFICIENCY ACCOUNT

DEBIT WITH			CREDIT WITH	
Loss from shrinkage in value of assets, per statement of affairs:			Deficiency as per statement of affairs	$-----
Customers' Accounts	$-----		Original Capital contribution upon the part of (a) single proprietor, (b) partners, or (c) stockholders	-----
Notes Receivable	-----		Profits from operation up to the date of liquidation	-----
Insurance Unexpired	-----			
Inventories	-----			
Land	-----			
Buildings	-----			
Machinery & Tools	-----			
Other Equipment	-----	$-----		
Withdrawals by (a) single proprietor, (b) partners, or (c) stockholders, in the shape of dividends		-----		
Losses from operation up to the date of liquidation		-----		
Total Debits		$-----	Total Credits	$-----

STATEMENT OF AFFAIRS

DEFINITION--Statement showing assets, liabilities, and net worth of a concern at a particular moment of time on a liquidating basis.

PURPOSE--

1. To set forth the total unsecured claims and net available assets from which payment can be made

2. To set up the proprietor's equity in the net assets on a forced liquidation basis in case of
   (a) Bankruptcy
   (b) Reorganization, and
   (c) Solvent concern desiring unusual credit

FORM--See illustration.

1. "Book Value" is sometimes shown contiguous to "Expected to Realize" column, and "Gross Liabilities" are sometimes shown contiguous to the "Expected to Rank" column.

2. Items in the "Book Value" and "Gross Liabilities" columns should agree with the balance sheet accounts.

EXPLANATION OF TERMS USED--

1. BOOK VALUE. Represents value of assets as shown by the books of account.

2. EXPECTED TO REALIZE. Estimated amount which can be realized on forced sale of assets and liquidation of outstanding liens thereon.

3. GROSS LIABILITIES. Represent the liabilities appearing on the books of account.

4. EXPECTED TO RANK. Estimated unsecured claims which will share proportionately in assets not subject to liens.

5. PREFERRED CREDITORS. Claims such as rent and wages which by law must be paid in full out of any available assets before any payment is made on unsecured claims.

6. FULLY SECURED CREDITORS. Claims having a lien on specific assets whose realizable value is sufficient to settle such claims in full.

7. PARTIALLY SECURED CREDITORS. Claims having a lien on specific assets whose realizable value is not sufficient to settle such claims in full. The excess of such claims over the realizable value of the assets on which the lien is held is considered unsecured.

8. UNSECURED CREDITORS. Claims having no lien on specific assets and payment of which will be made proportionately out of the net free assets.

9. NET FREE ASSETS. Represents the total amount which it is expected will be realized from the assets after all liens are settled, and after claims having a legal preference are paid.

DIFFERENTIATED FROM A BALANCE SHEET AS TO--

1. PURPOSE:
   A balance sheet shows the assets, liabilities, and net worth as a "going concern"; a statement of affairs shows the same data as a "liquidating" concern.

2. FORM:
   A balance sheet is arranged to show:
   (a) Assets, classified as between fixed and current
   (b) Liabilities, classified as between fixed and current
   (c) Net worth of proprietors, showing separately the net income for the last fiscal period
   A statement of affairs is arranged to show·
   (a) Net free assets
   (b) Total unsecured creditors
   (c) Amount the unsecured creditors may expect to receive on their claims
   (d) Deficiency or surplus to proprietors after all liabilities are liquidated

<u>DEFICIENCY</u> <u>ACCOUNT</u>--Condensed statement showing the causes of the insolvency.

REFERENCES:
Kester, Vol. II, pages 631-639
Hatfield, Chapter XVIII
Esquerre, Chapter XXXIX

COMPLETE ACCOUNTING COURSE--PART II

Lecture 2

SPECIAL POINTS IN PARTNERSHIP ACCOUNTING

Problem 4

Jones & Smith carried on a business together with plants at Seattle, Wash., and Portland, Ore., each having sole charge of a plant. The partnership agreement provided that:

1. The Seattle partner's salary to be at the rate of $6,000 per year and the Portland partner's salary at $2,500 per year plus one-fourth of the net profits of the Portland branch.

2. Interest to be allowed at the rate of 5% per annum on the capital invested, which amounted to $250,000, of which $100,000 was invested at Seattle and $150,000 at Portland.

3. Depreciation at 5% per annum to be written off Plant account and all repair and renewal charges absorbed in the Profit and Loss account in the period in which they are incurred. The investment in plant and buildings at Seattle was $140,000 and at Portland $210,000.

4. All interest charges in respect of borrowed money to be debited against the Profit and Loss account of each plant in the proportion of two-fifths to Seattle and three-fifths to Portland. The charges of this nature amounted to $6,750 for the year.

The profits for the year (before taking any of the foregoing items into consideration) totaled $77,500, of which $30,000 was earned by the Seattle branch and the balance by the Portland branch.

Prepare a statement setting out the net profit after deducting all charges and show the amounts to be credited to each partner's account.

Problem 5

January 1, 1918, A & B signed articles of copartnership to engage in a mercantile business, agreeing to invest $15,000 and $25,000, respectively. Profits were to be divided in proportion to the actual original capital contributed, and interest at 5% was to be allowed on investments in excess of the agreed contributions and was to be charged on deficits under the agreed contributions.

The trial balance of their books on December 31, 1918, was as follows:

A--Capital Account		$ 9,000.00
B-- " "		27,000.00
Purchases	$ 60,000.00	
Office Expenses	1,000.00	
Real Estate	5,000.00	
Building	10,000.00	
Customers' Accounts	12,000.00	
Cash on Hand	1,000.00	
Notes Receivable	8,000.00	
Furniture and Fixtures	2,000.00	
Discounts Received		1,000.00
Creditors' Accounts		7,000.00
Salaries and Wages	4,000.00	
Notes Payable		4,000.00
Sales		55,000.00
	$103,000.00	$103,000.00

The merchandise inventory on hand December 31, 1918, was valued at $10,000.

After allowing for interest on investments, divide the net profits in accordance with the agreement and submit the balance sheet as of December 31, 1918, and also a statement of the partners' capital accounts.

Problem 6

On January 1, 1919, a third party, C, desired to enter the partnership referred to in Problem 5, and it was agreed:

1. That C pay $9,000 in cash for a one-fourth interest in the new concern.
2. That the good-will of A & B be valued at $3,000.
3. That A & B adjust their capital accounts in accordance with C's investment so that they hold a one-fourth and one-half interest respectively in the new firm.
4. That profits and losses be divided according to actual original capital contributions.

In the adjustment, A received cash (out of the $9,000 paid in by C) for his excess investment, while B received the remainder of the $9,000 paid in by C, and the balance due him was considered a loan to the partnership for which he received a note.

Give journal entries necessary to record the above facts.

MISCELLANEOUS QUESTIONS

Question 6--In making an analysis of the Accounts Receivable controlling account for the month of January, 1918, you find the following items. Set them up in account form and close the account.

Balance January, 1918, $5,000; total net cash receipts per cash book, $8,000; sales, as per sales record, $15,000; total freight and other allowances, $120; total

of customers ledger debit column in the journal, $4,000; cash discounts allowed per cash book, $247.62; total notes receivable given by customers, and other journal credits, $1,250.

Question 7--A company is using the imprest system of handling petty cash and plans to open the account with $200. At the end of the first month it is found that the petty cash disbursements have been as follows: Postage $14; dinners $12; advertising $75; car-fare $9.20; miscellaneous general expense $7.

Outline the procedure to be followed in handling the fund and give the entries that should be made because of the disbursements and replenishment of the fund.

Question 8--Outline the entries that would be made on the books of a partnership to record its sale to a corporation.

Question 9--X of the partnership of X & Y borrows money for the purpose of purchasing, at a low figure, certain merchandise for the regular requirements of the business. He pledges certain other merchandise on hand as security for the note and turns over the cash realized. Under what further conditions would the cash thus received by the business be credited to any of the following accounts:

(a) Notes Payable
(b) Accounts Payable
(c) X--Loan Account
(d) X--Capital Account

Question 10--In preparing a statement of profits with a view of setting out the earning power of a partnership, which, if any, of the following items should be excluded and why: (a) interest on bonded indebtedness, bank loans, and other indebtedness, $52,500; (b) profit arising from the sale of property, $5,000; (c) settlement in connection with patent litigation extending over a period of ten years, $25,000; (d) management salaries, $100,000; (e) partnership excess profits tax for 1917, $5,000; (f) interest on partners' capital accounts, $15,000.

PARTNERSHIPS

Review Lecture 6, Part I.

Partnership accounting occasionally offers difficulties which may be classified under the following heads:

INTEREST ALLOWANCES--Interest is frequently allowed on capital accounts or allowed or charged on drawing accounts in order that due credit may be given each partner for the amount of capital which he retains in the business. The basis for the interest credit or debit will be found in the partnership agreement. Some of the common methods of computation are as follows:

1. Interest may be allowed on the excess of salary credits or other credits or amounts over drawings or charged on the excess of drawings over stipulated sums. For example, in the partnership of B & C it is provided (a) that interest computations shall be made at the end of each month; (b) that drawing accounts will be credited with (1) monthly profits, one-half to each partner, (2) salary allowances of $500 for B and $750 for C, (3) additional capital contributions or losses during the month, and debited with all drawings of whatever kind during the month;

(c) that interest at 6% will be computed on each sum as of the date contributed or withdrawn (including the opening balance at the beginning of the month), except that in the case of the credit or debit of monthly profit or loss and the credit of monthly salary, one-quarter of 1% thereof will represent the interest computation; (d) that the difference between the credit and debit interest items so computed will be the basis of a journal entry debiting or crediting the partners' drawing accounts and crediting or debiting "Interest--Partners' Drawing Accounts" account; and (e) that computations will be made on the basis of a 360-day year and a 30-day month. Under such provisions as outlined we might expect to find the drawing account of B for the month of July, 1918, somewhat as follows:

B--DRAWING ACCOUNT

DATE	PARTICULARS	AMOUNT	INTEREST	DATE	PARTICULARS	AMOUNT	INTEREST
July 6	Cash	$400.00	$ 1.67	July 1	Balance, June	$ 1,502.04	$ 7.51
" 27	Cash	700.00	.47	" 16	Additional Capital	10,000.00	25.00
" 31	Net Interest Credits		34.67	" 31	Salary, July	500.00	1.25
" 31	Balance carried down	12,157.88		" 31	Profits, July	1,221.17	3.05
				" 31	Interest per contra	34.67	
		$13,257.88	$36.81			$13,257.88	$36.81
				Aug. 1	Balance	$12,157.88	

2. Interest on capital accounts may be computed for the entire period on the balance at the beginning of the period. To continue the illustration in (1), it might be expected that interest would be credited to the capital accounts at the end of the year computed on the balance at the beginning of the year, inasmuch as all additions thereto or subtractions therefrom had been taken care of through the drawing accounts. Often interest on the capital accounts at the beginning of the period is the only interest on the partners' accounts, no account being taken of changes during the year.

In no case should interest be allowed unless the partnership agreement specifically provides therefor. It should also be remembered that unless the disparity between the capital accounts and the profit-sharing ratios is very great, or unless the capital interest is very large, little is gained by computing interest on drawing and capital accounts.

DRAWING ACCOUNTS--Drawing accounts are commonly credited with salary, interest, profits, and other allowances and debited with current withdrawals, interest, and various personal charges. On the other hand, each of the above elements may be carried in separate accounts and consolidated at the end of each accounting period.

CAPITAL ACCOUNTS--The original investment and subsequent profits (i.e., capital and surplus in the case of a corporation) are usually consolidated on the books of a partnership, being separated only as to partners. It has become

the practice to regard each partner's profits not withdrawn as additional investment. If additional cash is invested by a partner during a period it may be desirable to credit the amount to his drawing account in order to preserve the opening balance of his capital account intact throughout the period. Ordinarily, however, capital additions and capital withdrawals are credited or debited directly to the capital accounts.

GOOD-WILL--The manner in which good-will may be placed on the books of a corporation or partnership in case of purchase is described in Lecture 27, Part I. It will sometimes happen that in the reorganization of a partnership, in case a new member is taken into an established business, or for other reasons, a Good-Will account will be created, the credits offsetting the debit being made to the capital accounts of the partners already in the business on the basis of their profit and loss sharing ratios. Or the partnership agreement may provide that upon the death or retirement of a partner, his share in the good-will which has been created as a result of his efforts shall be credited to his capital account. A Good-Will account in such case will be opened, debiting thereto the amount credited to the partner's account, an entry which in fact records a purchase of good-will. The balance of the good-will computation applying to the remaining partners would not ordinarily be put on the books unless settlement with them is contemplated.

LIQUIDATING DIVIDENDS OF A PARTNERSHIP--When a partnership is dissolved, the capital accounts should be reduced by the first liquidating dividends to a profit and loss sharing ratio, so that subsequent dividends may be distributed without the danger of overpaying any one partner. Thus A, B, and C share profits and losses one-third each; their capital accounts are $30,000, $40,000, and $50,000 respectively, and liquidating dividends of $10,000, $20,000, and $15,000 are distributed in order on successive dates as follows:

	A	B	C	TOGETHER
Balance Capital Accounts	$30,000.00	$40,000.00	$50,000.00	$120.000.00
Dividend #1	- - - - -	- - - - -	10,000.00	10,000.00
	$30,000.00	$40,000.00	$40,000.00	$110,000.00
Dividend #2	- - - - -	10,000.00	10,000.00	20,000.00
	$30,000.00	$30,000.00	$30,000.00	$ 90,000.00
Dividend #3 (final)	5,000.00	5,000.00	5,000.00	15,000.00
Balance Net Loss from Realization	$25,000.00	$25,000.00	$25,000.00	$ 75,000.00

The above assumes that A, whose capital account is the lowest, will not make good any capital losses in excess of his capital investment. Without agreement to the contrary this assumption should always be made; otherwise the partner with the greatest invested capital may be the loser. To illustrate, suppose A had agreed with B and C to make good losses exceeding his capital account. The first dividend would then be distributed $2,000 to B and $8,000 to C, as may be seen from the following:

Balance of capital accounts	$120,000.00
Less dividend to be paid	10,000.00
Balance remaining, which for the purpose of distributing the dividend should be considered a complete loss	$110,000.00
Loss to each partner	$ 36,666.66

Subtracting this loss from each of the capital accounts, B is found to be entitled to $3,333.33 and C to $13,333.33, while A owes the firm $6,666.66. Awaiting subsequent liquidation, however, the debit in A's account would remain as an account receivable, while the dividend of $10,000 would be distributed pro rata (i.e., 1:4) between B and C, resulting in payments to them of $2,000 and $8,000, respectively.

REFERENCES:
Hatfield, Chapter XVII
Lisle, pages 194-232

COMPLETE ACCOUNTING COURSE--PART II

Lecture 3

STATEMENT OF REALIZATION AND LIQUIDATION

Problem 7 (For Class Work)

After due consideration of the statement of affairs (see II-1-5) A & B decided to liquidate. The cash received from the realization of customers' accounts was $82,000 and from inventories $84,500. The property assets were bid in by the mortgage holder for $130,000. For expenses of the proceedings $500 was paid out, and the balance of the funds used to pay off the unsecured creditors pro rata.

Prepare a realization and liquidation statement.

Problem 8

From the following information prepare a statement of affairs with a relative deficiency account:

Wages Unpaid		$ 3,000.00
Real Estate, Buildings, and other Plant Equipment		95,000.00
First Mortgage 6% Bonds		
(In Treasury $50,000)		
Bills Payable		50,000.00
(Secured by the deposit of $50,000 First Mortgage 6% Bonds)		
Trade Creditors		275,000.00
Notes Receivable:		
Good	$22,000.00	
Bad	3,000.00	
Doubtful (take up 50%)	8,000.00	33,000.00
Bank Overdraft		4,800.00
Cash on hand		400.00
Inventory of Merchandise		105,000.00
Partially Secured Trade Creditors		
(Secured by merchandise of a value of $30,000)		45,000.00
Ordinary Trade Accounts:		
Bad	$32,000.00	
Doubtful (50% probably good)	35,000.00	
Good	85,000.00	152,000.00
Capital Stock		200,000.00

Deficiency Account:

Balance as at January 1, 1917		$33,000.00	
Net Loss, year ending December 31:			
1917	$80,050.00		
1918	39,350.00	119,400.00	
		$152,400.00	
Dividends declared and paid		40,000.00	$192,400.00

Problem 9

After due consideration of the statement of affairs prepared April 30, the firm of Miller Brothers decided to liquidate, and Fred Miller was appointed receiver for that purpose. On July 2, 1918, he reported as follows:

COLLECTED	
Customers' Accounts	$23,000.42
Merchandise Inventory	26,500.50
Miscellaneous Supplies	100.00
Delivery Equipment	1,340.00
Fixtures	785.00
Advances	1,000.00
DISBURSED	
Taxes Accrued	$ 200.00
Notes Payable	10,000.00
Accounts Payable	36,080.00
Accommodation Paper	5,000.00
Bank Loan	3,000.00
Interest Accrued on Notes Payable	36.00
Expenses (including Wages)	1,544.70

$1,000 accommodation paper was renewed. The accommodation paper which August Miller had indorsed was charged to his capital account.

You are asked to prepare:

(a) Journal entries required by the bookkeeper to close the books;

(b) Realization and Liquidation account;

(c) Status of partners' accounts. The partnership agreement provided that profits and losses were to be divided as follows: Fred Miller 2/3; August Miller 1/3.

MISCELLANEOUS QUESTIONS

Question 11--Name and describe briefly the principal books of account of a business with which you are familiar.

Question 12--What is your understanding of the following terms:

(a) Book profits

(b) Inventory reserves

(c) Contingent liabilities

Question 13--In the examination of the customers' accounts you find certain credit balances aggregating $13,011.31 arising out of allowances in respect of returned goods, defective goods, etc. It has been the practice of the company to deduct items of this nature from sums due from customers and to state the net difference, in the balance sheet, as "uncollected customers' accounts." Have you any criticism to make of this treatment?

Question 14--Included among the accounts receivable are the following items:

(a) Bad debt suspense	$13,103.93
(b) President's drawing account	10,500.00
(c) Consignment stocks	51,708.25
(d) Working funds	1,250.00

Discuss whether or not these items have been properly classified.

Question 15--Set up the following information in account form as you would expect it to appear on the books of the consignee, and explain concisely what methods should be followed by the consignee in making an accurate record of such consignments if handled in large quantities: July 1, paid freight on shipment of 1 car (25,000 lbs.) of butter from the Bitter Hills Creamery Co., $123.50; cartage to storage, $45.75; July 14, sold 10,000 lbs. @ 47½¢; July 20, sold 12,000 lbs. @ 48 1/3¢; the balance was purchased by the consignee for his stock (small wholesale sales) at the average market price July 20, 48¢. The total storage costs were $78.90, one-half of which is charged by agreement to the consignor. In addition the consignee is entitled to a commission of 10% on gross sales and a 1% cash discount based on the amount that would otherwise be remitted if the balance due the consignor were not paid before July 31. Payment is made on July 25.

Solution to Problem 2

MILLER BROTHERS
STATEMENT OF AFFAIRS
APRIL 30, 1918

Book Value	ASSETS		Expected to Realize	Gross Liabilities	LIABILITIES		Expected to Rank
	CURRENT ASSETS:				PREFERRED CREDITORS:		
$ 3,676.84	Cash		$ 3,676.84	$---------	Wages	$173.00	
100.00	Petty Cash Fund		100.00	200.00	Taxes	200.00	
10,100.00	Notes Receivable:						
	Good	$10,100.00			Deducted per		
	Less Notes				contra	$373.00	
	Rec.-Dis.	10,000.00					
	Bad	$ 100.00		10,000.00	FULLY SECURED CREDITORS:		
35,542.00	Customers'				Notes Receivable Discounted		
	Accts.:						
	Good	$17,500.00	17,500.00		UNSECURED CREDITORS:		
	Doubtful			10,000.00	Notes Payable		$10,000.00
	(50%)	11,800.00	5,900.00	36,080.00	Accounts Payable		36,080.00
	Bad	6,242.00		3,000.00	Bank Loan		3,000.00
					Interest Accrued on		
		$35,542.00		36.00	Notes Payable		36.00
					Accommodation Paper of		
					A. Miller		6,000.00
1,100.00	Advances on Consignments-						
	Inward		1,000.00				
39,090.00	Merchandise		25,000.00				
300.00	Miscellaneous Supplies		100.00				
$89,908.84			$53,276.84				

	DEFERRED CHARGES:				
50.00	Unexpired Insurance				
200.00	Rent Paid in Advance				
$ 250.00					
	CAPITAL ASSETS:				
$ 1,750.00	Delivery Equipment	$ 1,200.00			
1,450.00	Warehouse & Office Fixtures	625.00			
$ 3,200.00		$ 1,825.00			
$93,358.84	Total Assets	$55,101.84	$59,316.00	Total Liabilities	$55,116.00
	DEDUCT--Preferred Creditors	373.00			
	Net Free Assets	$54,728.84			
	Deficiency to Creditors	387.16			
		$55,116.00			$55,116.00
				Deficiency to Creditors	$ 387.16
			17,625.23	Fred Miller	17,625.23
	Deficiency to Partners	$34,430.00	16,417.61	August Miller	16,417.61
$93,358.84		$34,430.00	$93,358.84		$34,430.00

DEFICIENCY ACCOUNT

Estimated Loss on Realization of Assets:			Capital Accounts:	
Notes Rec.	$ 100.00		Fred Miller	$17,625.23
Customers' Accts.	12,142.00		August Miller	16,417.61
Advances	100.00		Deficiency to Creditors per Statement of Affairs	387.16
Mdse. Inventory	14,090.00			
Misc. Suppl. Inventory	200.00			
Unexpired Insurance	50.00			
Rent Prepaid	200.00			
Delivery Equip.	550.00			
Fixtures	825.00	$28,257.00		
Accommodation Paper Indorsed by A. Miller		6,000.00		
Wages Accrued		173.00		
		$34,430.00		$34,430.00

Solution to Problem 3

NOTE--Indicate the good and the poor points of the following solution.

D & E
STATEMENT OF PROFIT AND LOSS ACCOUNT

MANUFACTURING ACCOUNT

Inventory of Raw Materials at January 1, 1919		$ 19,032.27	Inventory of Raw Materials at June 30, 1919	$ 16,103.78
Purchases of Raw Materials (including freight charges)		91,201.90	Discounts Received	1,301.03
Wages		8,111.03	Balance--being cost of manufacture carried to the Trading Account	106,590.92
Factory Expenses:				
Power, Light, and Heat	$1,100.50			
Miscellaneous Factory Expenses	3,400.03			
Insurance	900.00			
Taxes	250.00	5,650.53		
		$123,995.73		$123,995.73

TRADING ACCOUNT

Inventory of Finished Products on hand at January 1, 1919	$ 9,803.27	Gross Sales Invoiced		$120,032.03
Cost of Manufacture for the six months ended June 30, 1919, brought down	106,590.92	LESS--		
		Discounts Allowed	$2,100.75	
		Freight Allowances	2,925.09	5,025.84
Balance--Gross Profit on Sales carried to the Profit and Loss Account	18,715.98	Net Sales Invoiced		115,006.19
		Inventory of Finished Products on hand at June 30, 1919		20,103.98
	$135,110.17			$135,110.17

PROFIT AND LOSS ACCOUNT

Partners' Salaries	$ 4,800.00	Gross Profits on Sales brought down from Trading Account	$18,715.98
Interest on Partners' Capital Accounts	1,497.52	Rents Collected	900.00
Office Rent	900.00	Interest Received or Accrued on Bills Receivable	442.37
Traveling Expenses	1,425.50		
Advertising	1,783.03		
Office Salaries	4,004.50		
Interest Paid on Bank Loans	1,403.27		
Bad Debts Written Off	854.83		
Sundry Office Expenses	1,103.92		
	17,772.57		
Balance--Net Profits carried to the Partners' Drawing Accounts as follows:			
D 1,142.89			
E 1,142.89	2,285.78		
	$20,058.35		$20,058.35

BALANCE SHEET

ASSETS

CAPITAL ASSETS:		
Real Estate and Buildings	$ 3,700.00	
Machinery and Fixtures	10,011.93	
Office Furniture	990.62	
Total Capital Assets		$14,702.55
CURRENT ASSETS:		
Inventories	$36,207.76	
Customers' Accounts	24,093.27	
Bills Receivable	9,800.00	
Total Current Assets		70,101.03
		$84,803.58

LIABILITIES

	D	E	
CAPITAL ACCOUNTS:			
Balance at January 1, 1919	$32,113.29	$17,803.92	
Profits	1,142.89	1,142.89	
Interest on Capital Account	963.40	534.12	
Salaries	2,700.00	2,100.00	
	$36,919.58	$21,580.93	
LESS--Drawings	2,500.00	2,100.00	
BALANCE at June 30, 1919	$34,419.58	$19,480.93	
TOTAL of Capital Accounts			$53,900.51
CURRENT LIABILITIES:			
Bills Payable	$10,000.00		
Trade Creditors	19,803.04		
Accrued Interest and Taxes	1,100.03		
Total Current Liabilities			30,903.07
			$84,803.58

JOURNAL ENTRIES

(1)

Partners' Salaries	$ 4,800.00	
To--D--Drawing Account		$2,700.00
E-- " "		2,100.00

Salaries allowed to the respective partners under the partnership agreement.

(2)

Interest on Partners' Capital Account	$ 1,497.52	
To--D--Drawing Account		$ 963.40
E-- " "		534.12
Interest at 6% per annum for six months on each partners' capital investment at January 1, 1919.		

(3)

Raw Materials on hand June 30, 1919	16,103.78	
To--Manufacturing Account		16,103.78
To take up the inventory of raw materials on hand June 30, 1919.		

(4)

Merchandise (or Raw Materials Purchased) Account	3,111.32	
To--Freight on Purchases		3,111.32
To close latter account.		

(5)

Finished Products on hand June 30, 1919	20,103.98	
To--Trading Account		20,103.98
To take up the inventory of finished products on hand at June 30, 1919.		

CLOSING ENTRIES

(1)

Manufacturing Account	$123,995.73	
To--Inventory of Raw Materials at January 1, 1919		$19,032.27
Merchandise Account		91,201.90
Wages		8,111.03
Power, Light, and Heat		1,100.50
Miscellaneous Factory Expenses		3,400.03
Insurance		900.00
Taxes		250.00
To close foregoing accounts.		

(2)

Discounts Received	1,301.03	
To--Manufacturing Account		1,301.03
To close foregoing account.		

(3)

Trading Account	106,590.92	
To--Manufacturing Account		106,590.92
To transfer the cost of goods manufactured during the six months ended June 30, 1919 to the Trading Account.		

(4)

Sales Account	$120,032.03	
To--Trading Account		$120,032.03
To close foregoing account.		

(5)

Trading Account	14,629.11	
To--Discounts Allowed		2,100.75
Freight Allowances		2,925.09
Inventory of Finished Products on hand at January 1, 1919		9,603.27
To close foregoing accounts.		

(6)

Trading Account	18,715.98	
To--Profit and Loss Account		18,715.98
To transfer the gross profit on sales to the Profit and Loss Account.		

(7)

Rents Collected	900.00	
Interest Received or Accrued on Bills Receivable	442.37	
To--Profit and Loss Account		1,342.37
To close foregoing accounts.		

(8)

Profit and Loss Account	17,772.57	
To--Partners' Salaries		4,800.00
Interest on Partners' Capital Accounts		1,497.52
Office Rent		900.00
Traveling Expenses		1,425.50
Advertising		1,783.03
Office Salaries		4,004.50
Interest Paid on Bank Loans		1,403.27
Bad Debts Written Off		854.83
Sundry Office Expenses		1,103.92
To close foregoing accounts.		

(9)

Profit and Loss Account	2,285.78	
To--D--Drawing Account		1,142.89
E-- " "		1,142.89
To transfer net profit to drawing accounts.		

(10)

D--Drawing Account	2,306.29	
E-- " "	1,677.01	
To--D--Capital Account		2,306.29
E-- " "		1,677.01
To close drawing accounts.		

ANSWERS TO QUESTIONS

<u>Answer to Question 1</u>--There would be in this case a surplus belonging to stockholders which, if liquidation actually takes place, will be distributed among them. The form shown in Lecture 1 would be altered as follows:

Surplus belonging to Stockholders	$----	Capital Stock	$----
Balance--representing loss in book value of stockholders' investment	----	Surplus	----
	$----		$----

<u>Answer to Question 2</u>--

M S COMPANY
DEFICIENCY ACCOUNT

Losses arising from fire:			Profits from Operation for four months ending June 30, 1919	$-----
Buildings	$-----		Capital stock	-----
Fixtures	-----		Surplus	-----
Merchandise	-----	$-----		
Loss over book value on realization of Assets:				
Land	$-----			
Buildings	-----			
Customers' Accounts	-----			
Merchandise	-----			
Fixtures	-----	-----		
Dividends declared and paid in 1919		-----		
		$-----		$-----

<u>Answer to Question 3</u>--

(a) For a business of the type described the records are adequate. Many small retail businesses having a capital of a few thousand dollars may secure from such records all the information necessary for credit and income tax purposes, as well as for their own purposes.

(b) A balance sheet together with a supporting profit and loss statement may be easily prepared. The assets would probably consist of only merchandise and cash, and there would be no liabilities. The surplus at the end of the

period would be the surplus at the beginning, plus net profits, less dividends paid.

(c) The system followed would be a double-entry system, provided the statements described in (b) balance and are prepared regularly. The columnar cash book in this case becomes a ledger.

Answer to Question 4--In arranging the accounts to be kept in a general ledger of a single proprietor, partnership, or corporation the following order is usually adopted:

1. Capital liability accounts, including: single proprietor's, partners' capital and drawing accounts; capital stock, surplus, and other capital liability accounts.
2. Capital asset accounts, with proper sub-classification for each of the various units of a company's property and holdings.
3. Current asset accounts--in the same order in which the various items would appear in the balance sheet.
4. Current liability accounts--in the same order in which the various kinds of current liabilities would be stated in the balance sheet.
5. Profit and loss or nominal accounts, with the accounts arranged in the same order in which the items would appear in the regular periodical statements prepared.

A preferable method in many cases is to show, first, the assets in the order they appear on the balance sheet; second, the liabilities in the order they appear on the balance sheet; third, the profit and loss accounts in the order they appear on the periodical statement of profits and income.

Answer to Question 5--

(a) A STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS is a summary of the cash transactions for a period regardless of whether they are in respect of income and expenditure pertaining to that period, or not. On the left-hand side is shown:

1. The cash on hand or in bank at the beginning of the period
2. The receipts for the period under appropriate descriptive headings

and on the right-hand side is shown:

1. The disbursements for the period under appropriate descriptive headings.
2. The balance on hand or in bank at the end of the period

Both revenue and capital receipts and disbursements are included.

(b) A STATEMENT OF INCOME AND EXPENDITURE is a term applied to the operating statement of a non-trading concern and shows the income and expenses for the period, whether received, paid, or outstanding, and thus corresponds to a profit and loss account. It does not include capital receipts or capital expenditures.

These two statements differ in that the former is prepared on a cash basis while the latter is prepared on a profit and loss basis.

REALIZATION AND LIQUIDATION ACCOUNT

DEFINITION--Statement showing in summarized form the results of the liquidation of a business.

FORM--

(Name of Concern)
REALIZATION AND LIQUIDATION ACCOUNT
(Date)

ASSETS TO BE REALIZED:			LIABILITIES TO BE LIQUIDATED:		
Land	$-----		Notes Payable	$-----	
Buildings	-----		Audited Vouchers	-----	$-----
Equipment	-----				
Inventories	-----		ADDITIONAL LIABILITIES TO BE LIQUIDATED		-----
Customers' Accounts	-----				
Notes Receivable	-----	$-----	PROCEEDS FROM REALIZATION OF ASSETS		-----
ADDITIONAL ASSETS DISCLOSED		-----	ASSETS NOT REALIZED		-----
LIABILITIES LIQUIDATED		-----	BALANCE--Net Loss on Realization and Liquidation		-----
LIABILITIES NOT LIQUIDATED		-----			
EXPENSES OF REALIZATION AND LIQUIDATION		-----			
BALANCE--Net Profit on Realization and Liquidation		-----			
		$-----			$-----

Dividend to Creditors ......%.

EXPLANATION OF TERMS USED--

1. ASSETS TO BE REALIZED are the assets shown by the books or the latest balance sheet. They are listed at book values. Cash is not included because it is already realized.
2. ADDITIONAL ASSETS DISCLOSED. Refers to assets not appearing on the books which can be realized upon for the purpose of meeting liabilities to be liquidated.
3. LIABILITIES TO BE LIQUIDATED. Refers to the liabilities appearing on the books or latest balance sheet which are to be paid from the proceeds of the assets realized upon.
4. ADDITIONAL LIABILITIES TO BE LIQUIDATED. Refers to liabilities which must be paid but which do not appear on the books.
5. LIABILITIES LIQUIDATED. Refers to the liabilities listed under (3) or (4) which have been paid by the receiver or liquidator.
6. LIABILITIES NOT LIQUIDATED. Refers to the liabilities listed under (3) or (4) which have not been paid at the date the statement is prepared.
7. PROCEEDS FROM REALIZATION OF ASSETS. Refers to the amount realized from the sale of assets listed under (1) or (2).

8. ASSETS NOT REALIZED. Refers to the assets listed under (1) or (2) which have not been disposed of at the date the statement is prepared.

9. EXPENSES OF REALIZATION AND LIQUIDATION. Refers to the expenses incurred by the receiver or liquidator in disposing of the assets and discharging the liabilities.

10. BALANCE. The difference between the items on the debit and credit sides represents the profit (in case the credits exceed the debits) or loss (in case the debits exceed the credits) on realization and liquidation.

11. "CASH" does not appear as an "Asset to be Realized" or as an "Asset Not Realized."

LEDGER ACCOUNTS--Two methods are in general use:

1. A Realization and Liquidation account is opened in the general ledger. By journal entries the assets to be realized are charged to this account and the liabilities to be liquidated are credited thereto. Additional assets disclosed would be charged to the Realization and Liquidation account by journal entry, the contra credit being the Profit and Loss account or an investment account. Similarly, additional liabilities to be liquidated would be credited to the Realization and Liquidation account and, per contra, charged to the Profit and Loss account or an investment account. The debits for liabilities liquidated are posted from the liquidators' cash disbursements book and the credits for assets realized are posted from the cash receipts book. Expenses of realization and liquidation will be posted from the cash disbursements book.

2. Instead of transferring the assets and liabilities to a general Realization and Liquidation account, the proceeds from the sale of each asset may be credited directly to the respective asset accounts, and the payment of each liability may be charged directly to the respective liability accounts. Any profits or losses on realization are then transferred to the Profit and Loss account.

ENTRIES--

1. Transfer all assets to be realized to the Realization and Liquidation account.

2. Transfer all liabilities to be liquidated to the Realization and Liquidation account.

3. Take up any additional assets disclosed.

4. Take up any additional liability to be liquidated.

5. Credit Realization and Liquidation account with proceeds from sale of assets as per cash receipts book.

6. Debit Realization and Liquidation account with liabilities discharged as per cash disbursements book.

7. Where a debit is liquidated by transfer of an asset make a journal entry within the account for record purposes, as follows:

Realization and Liquidation Account	$--------	
To--Realization and Liquidation Account		$--------
To record transfer of .... in payment of		

8. Debit Realization and Liquidation account with expenses of realization as per cash disbursements book.

WHEN THE REALIZATION AND LIQUIDATION ACCOUNT IS TO BE STATED it is customary for record purposes to make memorandum journal entries charging and crediting Realization and Liquidation account in order to show "Liabilities not Liquidated" and "Assets not Realized" on the face of the Realization and Liquidation account, as follows:

(1)

Realization and Liquidation Account	$--------	
To--Realization and Liquidation Account		$--------
To record assets not realized at		

(2)

Realization and Liquidation Account	--------	
To--Realization and Liquidation Accounts		--------
To record liabilities not liquidated at........		

In entry (1) the credit only would be posted and in entry (2) the debit only would be posted. The effect of these postings is to cancel the original charge for asset to be realized and the original credit for liability to be liquidated. Then the profit and loss on realization and liquidation is ascertained and transferred by journal entry, as follows:

(3)

Profit and Loss Account	$--------	
To--Realization and Liquidation Account		$--------
To transfer loss to date.		

Having balanced the Realization and Liquidation account, post the debit of entry (1) and the credit of entry (2) and proceed as before.

The alternative method would be to transfer to the respective asset and liability accounts all assets not realized and liabilities not liquidated. After eliminating the profit or loss as shown in entry (3) retransfer the assets and liabilities to the Realization and Liquidation account.

BOOKS OF RECEIVER--If concern is to be continued under a receiver instead of liquidating immediately, it is advisable to

1. Transfer the assets and liabilities to the receiver at the expected-to-realize and expected-to-rank values. The difference between these values and the book values would be closed into the Profit and Loss account.
2. The receiver would open a new set of accounts starting out with the assets and liabilities taken over. The excess of assets and liabilities would be credited to the bankrupt estate.
3. The assets and liabilities created through the receiver's operations should be separated rigorously from the assets and liabilities taken over from the estate.

REFERENCES:
Kester, Vol. 2, pages 639-650
Esquerre, Chapter XL

COMPLETE ACCOUNTING COURSE--PART II

Lecture 3

STATEMENT OF REALIZATION AND LIQUIDATION

Problem 7 (For Class Work)

After due consideration of the statement of affairs (see II-1-5) A & B decided to liquidate. The cash received from the realization of customers' accounts was $82,000 and from inventories $84,500. The property assets were bid in by the mortgage holder for $130,000. For expenses of the proceedings $500 was paid out, and the balance of the funds used to pay off the unsecured creditors pro rata.

Prepare a realization and liquidation statement.

Problem 8

From the following information prepare a statement of affairs with a relative deficiency account:

Wages Unpaid		$ 3,000.00
Real Estate, Buildings, and other Plant Equipment		95,000.00
First Mortgage 6% Bonds		
(In Treasury $50,000)		
Bills Payable		50,000.00
(Secured by the deposit of $50,000 First Mortgage 6% Bonds)		
Trade Creditors		275,000.00
Notes Receivable:		
Good	$22,000.00	
Bad	3,000.00	
Doubtful (take up 50%)	8,000.00	33,000.00
Bank Overdraft		4,800.00
Cash on hand		400.00
Inventory of Merchandise		105,000.00
Partially Secured Trade Creditors		
(Secured by merchandise of a value of $30,000)		45,000.00
Ordinary Trade Accounts:		
Bad	$32,000.00	
Doubtful (50% probably good)	35,000.00	
Good	85,000.00	152,000.00
Capital Stock		200,000.00

Deficiency Account:

Balance as at January 1, 1917		$33,000.00	
Net Loss, year ending December 31:			
1917	$80,050.00		
1918	39,350.00	119,400.00	
		$152,400.00	
Dividends declared and paid		40,000.00	$192,400.00

Problem 9

After due consideration of the statement of affairs prepared April 30, the firm of Miller Brothers decided to liquidate, and Fred Miller was appointed receiver for that purpose. On July 2, 1918, he reported as follows:

COLLECTED	
Customers' Accounts	$23,000.42
Merchandise Inventory	26,500.50
Miscellaneous Supplies	100.00
Delivery Equipment	1,340.00
Fixtures	785.00
Advances	1,000.00
DISBURSED	
Taxes Accrued	$ 200.00
Notes Payable	10,000.00
Accounts Payable	36,080.00
Accommodation Paper	5,000.00
Bank Loan	3,000.00
Interest Accrued on Notes Payable	36.00
Expenses (including Wages)	1,544.70

$1,000 accommodation paper was renewed. The accommodation paper which August Miller had indorsed was charged to his capital account.

You are asked to prepare:

(a) Journal entries required by the bookkeeper to close the books;
(b) Realization and Liquidation account;
(c) Status of partners' accounts. The partnership agreement provided that profits and losses were to be divided as follows: Fred Miller 2/3; August Miller 1/3.

MISCELLANEOUS QUESTIONS

Question 11--Name and describe briefly the principal books of account of a business with which you are familiar.

Question 12--What is your understanding of the following terms:

(a) Book profits
(b) Inventory reserves
(c) Contingent liabilities

COMPLETE ACCOUNTING COURSE--PART II

Lecture 4

CAPITAL AND REVENUE EXPENDITURES

Problem 10

The balance sheet of the Miller Motor Car Co. on June 30, 1918, was as follows:

MILLER MOTOR CAR CO.
BALANCE SHEET, JUNE 30, 1918

ASSETS

	COST	RESERVE FOR DEPRECIATION	PRESENT VALUE	
CAPITAL ASSETS:				
Land	$ 40,000.00	$----------	$ 40,000.00	
Buildings	70,000.00	200.00	69,800.00	
Machinery, Tools, and Equipment	165,603.50	2,213.36	163,390.14	
Office and Warehouse Fixtures	2,045.00	17.48	2,027.52	
Delivery Equipment	1,750.00	43.76	1,706.24	
	$279,398.50	$ 2,474.60	$276,923.90	
Good-will			66,000.00	$342,923.90
INVESTMENT IN DURANT TRUCK CO.				200,000.00
CURRENT ASSETS:				
Inventories:				
Automobiles		$ 30,550.00		
Finished Parts		18,463.72		
Work in Progress		26,132.11		
Raw Materials		3,740.80		
Coal		3,500.00		
Stationery and Printing		100.00	$ 82,486.63	
Accounts and Notes Receivable:				
Customers' Accounts		$104,013.40		
Notes Receivable		116,003.00		
Accrued Interest on Notes Receivable		315.92		
		$220,332.32		

Deduct--Reserves for:				
Bad Debts	$1,522.75			
Discounts	1,800.00	3,322.75	217,009.57	
CASH:				
Cash in Bank		$ 50,186.45		
Petty Cash Fund		500.00	50,686.45	350,182.65
DEFERRED CHARGES:				
Advances to Salesmen			$ 2,000.00	
Unexpired Insurance			766.66	
Rent Paid in Advance			100.00	
Discount on Stock			2,000.00	4,866.66
TOTAL ASSETS				$897,973.21

LIABILITIES

CAPITAL STOCK:				
7% Preferred--Authorized and Issued (1,000 shares, par value $100 each)			$100,000.00	
Common--Authorized (5,000 shares, par value $100 each)		$500,000.00		
Issued and Outstanding			433,900.00	$533,900.00
BONDED INDEBTEDNESS:				
5% First Mortgage Bonds			$150,000.00	
6% First Mortgage Bonds			75,000.00	225,000.00
CURRENT LIABILITIES:				
Audited Vouchers			$ 60,144.12	
Accrued Liabilities:				
Pay-roll		$ 41,649.55		
Bond Interest		4,625.00		
Taxes		2,295.34	48,569.89	108,714.01
SURPLUS:				
Balance, June 1			$ 7,265.02	
Add--Profits for June			25,844.18	
			$ 33,109.20	
Deduct--Dividends Declared and Paid				
Preferred Stock 1.75%		$ 1,750.00		
Common Stock 1.00%		1,000.00	2,750.00	30,359.20
				$897,973.21

On July 1, 1918, the plant was destroyed by fire. At a special meeting of the Board of Directors held the following day, a committee was appointed to examine into the affairs of the company and report their finding to the Board.

July 6, 1918, the special committee reported as follows:

1. Buildings, machinery and equipment, delivery equipment, fixtures, and inventories, were totally destroyed. Insurance carried was $100,000.
2. Estimated salvage, of which $10,000 pertains to inventories, $40,000.
3. No insurance is carried on inventories.
4. Value of land appreciated, $5,000.
5. Notes receivable--$25,000 considered good; $50,000 considered doubtful, of which it is estimated 30% will be recovered; the balance, $41,003, desperate.
6. Customers' accounts--$30,000 considered good; $30,000 doubtful, of which it is estimated 50% will be recovered; $44,013.40, desperate.
7. Accrued interest on notes receivable--all but $103.42 considered good.
8. Good-will--In event of liquidation it is worthless.
9. Bond interest--$200 has accrued to date.
10. Investment will realize $100,000.
11. Expenses of realization and liquidation estimated at $12,500.

You are retained by the committee to prepare a statement of affairs and a deficiency account.

Problem 11

A corporation was formed under the laws of the State of Illinois with an authorized capital stock of $2,000,000, divided into 20,000 shares of par value of $100 each, all of which was subscribed for and subsequently paid in in cash, aside from $300,000 (par value) which was satisfied by the subscriber turning in real estate and other property upwards of that value.

Formulate the necessary opening entries to be given effect to on the books of the company in respect to the above-mentioned transactions.

Problem 12

Five years after the organization of the corporation described in Problem 11, a stock dividend of 50% was declared, and at the same time $1,000,000 preferred stock was authorized and offered for sale at par to holders of common stock and at 121 to outsiders. The holders of common stock were allowed to subscribe up to 40% of their holdings in common, not including the stock dividend. They took advantage of this privilege in full, and the balance was disposed of to the public at the offered price.

Provide journal entries for the above transactions.

MISCELLANEOUS QUESTIONS

Question 16--What do you understand by the term "deferred charges to operating or income"? Name a few items that ordinarily are regarded as being deferred charges.

Question 17--What is your understanding of the term "Notes Receivable Discounted"? How should an item of this kind be dealt with in stating the balance sheet at the end of a period?

Question 18--What do you understand by the following terms:

(a) Provision or Reserve for Bad and Doubtful Accounts
(b) Accrued Taxes
(c) Accrued Wages

Draw up a skeleton ledger account showing the nature of the transactions that would ordinarily enter into the accounts referred to. How would the respective items be shown in a balance sheet?

Question 19--How would you distinguish between plant and machinery expenditures chargeable to capital asset accounts and those chargeable to ordinary repair and maintenance accounts?

Question 20--Do you consider that the following expenditures are proper additions to the property accounts?

(a) Repairs to buildings, machinery, and other equipment at a total cost of $8,110.17.
(b) Purchase of horses, wagons, and stable equipment at a cost of $11,000--no depreciation has been provided in respect of a similar asset now standing upon the books of the company.

Solution to Problem 4

NOTE--See pages 6 and 7 for the solution to this problem.

Solution to Problem 5

A & B
BALANCE SHEET, DECEMBER 31, 1918

ASSETS			LIABILITIES		
CAPITAL ASSETS:			CAPITAL ACCOUNTS:		
Real Estate	$ 5,000.00		A--December 31, 1918	$ 9,000.00	
Building	10,000.00		B--December 31, 1918	28,000.00	$37,000.00
Furniture and Fixtures	2,000.00	$17,000.00			
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash	$ 1,000.00		Notes Payable	$4,000.00	
Notes Receivable	8,000.00		Creditors' Accounts	7,000.00	11,000.00
Customers' Accounts	12,000.00				
Merchandise Inventory	10,000.00	31,000.00			
		$48,000.00			$48,000.00

A & B
STATEMENT OF PARTNERS' CAPITAL ACCOUNTS
DECEMBER 31, 1918

	A	B	TOGETHER
Balance, January 1, 1918	$9,000.00	$27,000.00	$36,000.00
Add Interest	--------	100.00	100.00
	$9,000.00	$27,100.00	$36,100.00
Deduct Interest	300.00	--------	300.00
	$8,700.00	$27,100.00	$35,800.00
Add Profits	300.00	900.00	1,200.00
Balance, December 31, 1918	$9,000.00	$28,000.00	$37,000.00

Solution to Problem 4

FIRST METHOD

	SEATTLE	PORTLAND	TOGETHER		SEATTLE	PORTLAND	TOGETHER
Partners' Salaries	$ 6,000.00	$ 2,500.00	$ 8,500.00	Profits (before deducting Partners' Salaries, Interest on Borrowed Money and Capital Investment, Depreciation, and Portland Mgr's share of profits)	$30,000.00	$47,500.00	$77,500.00
Interest on Borrowed Money	2,700.00	4,050.00	6,750.00				
Interest on Capital Investment	5,000.00	7,500.00	12,500.00				
Depreciation 5% on Plant Account	7,000.00	10,500.00	17,500.00				
	$20,700.00	$24,550.00	$45,250.00				
Profits (before deducting Portland Mgr's interest (¼) in profits of that branch)	9,300.00	22,950.00	32,250.00				
	$30,000.00	$47,500.00	$77,500.00		$30,000.00	$47,500.00	$77,500.00
Portland Mgr's ¼ interest in profits of that branch--as per agreement ¼ of $22,950		$ 5,737.50	$ 5,737.50	Profits (before deducting Portland Mgr's interest (¼) in the profits of that Branch)	$ 9,300.00	$22,950.00	$32,250.00
Balance--Net Profits (after deducting all charges) carried to Partners' accounts							
Seattle Partner	4,650.00	8,606.25	13,256.25				
Portland Partner	4,650.00	8,606.25	13,256.25				
	$9,300.00	$22,950.00	$32,250.00		$9,300.00	$22,950.00	$32,250.00

One of the points that it was intended to bring out in this problem is whether or not the Portland manager's commission, or one-fourth interest in the profits, should be considered as part of the expense of conducting the business and accordingly charged against the profits in arriving at the amount in which the manager participates.

There is hardly any question but that the above solution is that which would be ordinarily arrived at in business practice in the absence of an agreement setting out the specific items of expenditure to to be considered as a charge against the Profit and Loss account.

After all, any commission or interest in profits is only one way of determining the compensation to be allowed a manager and is therefore equivalent to salary. Based upon this theory the problem would be solved in the following manner:

SECOND METHOD

	SEATTLE	PORTLAND	TOGETHER		SEATTLE	PORTLAND	TOGETHER
Partners' Salaries Seattle Partner	$ 6,000.00		$ 6,000.00				
Portland Partner Guaranteed Salary $2,500 25% of Profits-- $18,360 4,590		7,090.00	7,090.00				
Interest on Borrowed Money	2,700.00	4,050.00	6,750.00	Profits (before deducting Partners' Salaries, Interest on Borrowed Money and Capital Investment, Depreciation and Portland Mgr's share of the profits)	$30,000.00	$47,500.00	$77,500.00
Interest on Capital Investment	5,000.00	7,500.00	12,500.00				
Depreciation 5% on Plant Acct.	7,000.00	10,500.00	17,500.00				
	$20,700.00	$29,140.00	$49,840.00				
Net Profits carried to the Partners' Accounts: Seattle Partner	4,650.00	9,180.00	13,830.00				
Portland Partner	4,650.00	9,180.00	13,830.00				
	$30,000.00	$47,500.00	$77,500.00		$30,000.00	$47,500.00	$77,500.00

Solution to Problem 6

(1)

Cash	$ 9,000.00	
To--C--Capital Account		$ 9,000.00
For a one-quarter interest in the partnership.		

(2)

Good-Will	3,000.00	
To--A--Capital Account		750.00
B--Capital Account		2,250.00
Division of good-will between partners on basis of original capital contributed.		

(3)

A--Capital Account	750.00	
To--Cash		750.00
To reduce A's investment to one-quarter of the partnership capital.		

(4)

B--Capital Account	12,250.00	
To--Cash		8,250.00
Notes Payable		4,000.00
To reduce B's investment to one-half of the partnership capital.		

ANSWERS TO QUESTIONS

Answer to Question 6--

CUSTOMERS' LEDGER

1918				1918			
January	1	Balance	$ 5,000.00	January	31	Cash	$ 8,000.00
"	31	Sales	15,000.00	"	31	Discounts allowed	247.62
"	31	Journal	4,000.00	"	31	Notes, etc.	1,250.00
				"	31	Freight, etc., allowances	120.00
				"	31	Balance	14,382.38
			$24,000.00				$24,000.00
February	1	Balance	$14,382.38				

Answer to Question 7--The Petty Cash account will be charged originally with $200. As disbursements are made by the petty cashier, vouchers, or debit tickets, will be taken in receipt therefor. The petty cashier makes up a petty cash sheet from the debit slips on hand and a voucher is prepared as for any other payment; an officer of the corporation O K's the voucher, which is then passed on for payment by the general or disbursing cashier. An entry will be made in the cash disbursements book at the time of the replenishment of the fund as follows:

Postage	$14.00	
Dinners	12.00	
Advertising	75.00	
Car-fare	9.20	
Miscellaneous General Expense	7.00	
To--Cash		$117.20

<u>Answer</u> <u>to</u> <u>Question</u> <u>8</u>--The following journal entries would be made:

(1)

Good-Will	$--------	
To--M--Capital Account		$--------
N-- " "		--------

To set up Good-Will on books prior to sale thereof to Smith Manufacturing Co.

(2)

Smith Manufacturing Co., Vendee	--------	
To--Land		--------
Buildings		--------
Machinery		--------
Good-Will		--------
Merchandise		--------
Etc.		--------

To record transfer of assets to Smith Manufacturing Co. as per bill of sale dated.......

(3)

Accounts Payable	--------	
Notes Payable	--------	
To--Smith Manufacturing Co., Vendee		--------

To record assumption of liabilities by Smith Mfg. Co.

(4)

Capital Stock of Smith Manufacturing Co.	--------	
To--Smith Manufacturing Co., Vendee		--------

Payment for net assets acquired as per bill of sale.

(5)

M--Capital Account	--------	
N--Capital Account	--------	
To--Capital Stock of Smith Manufacturing Co.		--------

Distribution of remaining assets to partners.

NOTES--

1. Without instructions to the contrary good-will will be credited to the partners' capital accounts according to the profit and loss sharing ratio.
2. Not all the assets and liabilities of the partnership may be transferred, in which case the partnership books should be continued until complete liquidation is effected.

Answer to Question 9--

(a) Notes Payable would be credited if X signed the note as a member of the firm.

(b) Accounts Payable might be credited if the agreement with the creditor provides that the note, although a liability solely of X's, is to be paid by the partnership to the payee.

(c) If it is agreed among the partners that the money secured by X is to be considered as a special loan to the partnership, the cash received would be credited to X--Loan Account, no matter whether evidenced by a note from the partnership or not.

(d) X--Capital Account should be credited if the partners look upon the cash received as additional capital invested. The treatment would depend entirely on the facts in the case.

Answer to Question 10--

(a) Interest of $52,500 on bonded and other indebtedness should be excluded in preparing a statement setting forth the earning power of a business, on the ground that interest in this case is a division of profits rather than expense of operation.

(b) The profit of $5,000 arising from the sale of property is not one relating to the ordinary operations of the business, i.e., from the manufacture and sale of a product or from trading operations. If the item were included in the statement of profits and income at all, it would be included as "Extraordinary Profits" and taken up after arriving at the profits pertaining strictly to the ordinary business operations.

(c) There is some question as to whether or not the litigation expense of $25,000 should be excluded. More information would have to be obtained in regard to the character of the business of the company for whom the statement of profits is to be prepared. The word "patent" suggests that the company is manufacturing a patented article which may or may not conflict with patents granted to others. The charge would probably be made against the current period's income as an extraordinary expenditure unless a reserve had been previously created to cover the probable liability. In that case it would be charged against the reserve.

(d) Management salaries are at all times proper charges against the cost of doing business and go in reduction of the NET operating profits. The amount of $100,000 suggests, however, that the payment in respect of management salaries is perhaps disproportionate to the business done and is, therefore, in effect a partial division of profits. This is particularly true if the managers are the stockholders or owners of the business. If this condition existed it would appear desirable to set out the amount of the management salaries on the face of the statement of profits.

(e) It would be excluded, partnerships being no longer subject to such tax.

(f) Interest on capital accounts would also be excluded. There would be no need of making any reference to such interest in the statement of profits except for the general information conveyed.

CAPITAL AND REVENUE EXPENDITURES

1. ACCOUNTS TO BE CHARGED--Expenditures involving the extension or maintenance of capital assets should be charged to:

(a) Property Account
(b) Depreciation Reserve
(c) Deferred Charges
(d) Operating Expenses
(e) Profit and Loss
(f) Surplus, or
(g) Improvement Reserve

depending on the character and purpose of the expenditure.

2. BASES UNDERLYING THE DETERMINATION OF THE ACCOUNT TO BE CHARGED--

The following is an extract from Mr. Dickinson's paper on "Profits of a Corporation" relating to construction expenditures:

"In completing the survey of the conditions so far as regards Capital Assets, it is well to consider what expenditures may reasonably be added to the original investment of Capital, instead of being charged against Profits. These expenditures may be divided into the following general classes:

"(a) Actual additions to the property, such as new buildings, new engines or new tools, which did not exist before, or additions to existing articles of this class. All such expenditure would be at once admitted as a proper charge to Capital Account.

"(b) Alterations to Capital Assets resulting in increased capacity, some portion, but not the whole of which in most cases may be charged to Capital Account.

"(c) Alterations to Capital Assets resulting not in increased capacity but in a lower cost of output. Such items are frequently treated as additions to Capital Account, even by conservative corporations, but it may be doubted whether they should not rather be considered as operating expenses paid in advance, especially if, as in most manufacturing concerns, the processes to which the improvements are applied have only a limited life, after which they will be superseded by other and more modern ways of doing the same thing. In other words, the most conservative way of treating this class of expenditures would be to consider them as deferred charges to operating to be

written off over a definite term of years against Profits. Among this class may be mentioned change of grade or alignment in railroads which is too frequently treated as a capital charge; the shifting of machinery from one position to another, or a general rearrangement of a factory; as well as stripping and development work, on mineral lands, which is of a capital nature in so far as it is money sunk in the property prior to taking anything out of it, but in all conservatively managed mines is treated in the way indicated above.

"(d) Alterations to capital assets resulting partly in increased output and partly in decreased operating expenses. In this class much must depend on the nature of the expenditure, but a division between capital and operating accounts on some definite basis arrived at on the principles outlined in (b) and (c) would as a rule be fair and conservative treatment.

"(e) Exceptional and extraordinary renewals of existing assets resulting partly in the increased capacity necessary in order to keep pace with more modern plants, partly in diminished operating expenses and partly in a mere replacement. Such expenditures include the modernizing of a property necessary to prevent or to repair a deterioration in its value, due either to the competition of more modern properties or to the greater demands of the public, and consequently not resulting in increased earnings. Here again many corporations will charge part of such expenditures to Capital Account, and would be legally justified in so doing; but undoubtedly the sane and conservative course is to charge them wholly against Profits through the medium of a Depreciation or Improvement Fund.

"(f) Finally, we have ordinary replacements, repairs and renewals recurrent either at long or short intervals, and resulting neither in increased capacity nor in saving in operating expenses. Such would always be a charge against Profits, either through the Depreciation Fund or direct, according to the nature of the outlay."

3. BASIS UNDERLYING THE DETERMINATION OF THE AMOUNT AT WHICH THE CHARGE SHOULD BE MADE--

"It is important to note that the charges made under any of the above headings should be cost only and should not include any addition by way of Profit. The operation is merely a conversion of Current into Fixed Assets, upon which no Profit can be realized as long as the Asset is maintained. Possibly, however, where a corporation employs in the erection of plant for its own purposes facilities which it would otherwise be employing in similar erections for outsiders at a Profit, it would be fair, although not conservative, to consider a reasonable charge for the use of these facilities as part of the cost of erection. Also when special loans are raised for construction purposes, the interest on such loans during the period of construction would fairly be part of the cost.

"SALE OF FIXED ASSETS. If Fixed Assets, becoming unnecessary for the purposes of the business, are sold or are abandoned and dismantled, the question arises whether Profit or Loss arising therefrom should be added to or

deducted from the Profit arising from the general operations. Legally, if as a result of a revaluation of Capital Assets a surplus was found to exist, the realized portion thereof may probably be treated as a Profit, but not otherwise; and on the other hand there would not appear to be any legal necessity to provide for a loss. As a matter of accounting, the safe policy is to carry forward Profits and provide for Losses, but the circumstances in each case must be considered. Where the losses are large, as in the case of the dismantling of a whole plant, it would be sufficient to provide for it gradually out of the profits of a series of years."

The following is an extract from Mr. Dickinson's paper "Special Points in Corporation Accounting":

"In the paper dealing with the 'Profits of a Corporation,' to which reference has already been made, some general rules were laid down as to different classes of expenditures, which might be legitimately considered as an addition to capital assets, and it is now proposed to consider the equally important point of the method of ascertaining the amount of such expenditures when the work is carried out by the corporation itself.

"The problems involved in the determination of the proper charges to be made for construction work are:

"Firstly, to correctly ascertain the actual labor and material expended thereon, which if proper records be kept, is a comparatively easy matter, and

"Secondly, to determine the amount, if any, which should be added to these direct costs for general and management expenses, and possibly for interest.

"In a going concern a conservative course is generally adopted, and no charge is made beyond the labor and material cost, for expenditures of moderate amount on additions to the property; but, on the other hand, if a new and distinct plant were in course of construction, and producing no earnings from operation, the whole of the administration expenses, and the interest paid on Loans raised for this special purpose would be charged to construction account, and rightly so being necessary elements of completing the work. This at once suggests the argument that what is reasonable and proper in the latter case should also be reasonable and proper in the former, particularly if facilities are employed which would otherwise be used on profitable work for outside parties. It must, however, be remembered that profits can only be made out of the sale of products; and that it is, therefore, incorrect that a concern should take credit for profits on work which is not intended for sale, and will, in all probability, never be sold as long as the concern is continuing to carry on business.

"It would follow then that no charges should be made to construction for expenses which would have been equally incurred if there had been no such construction, and would in that case have been charged against profits; although if special loans have been raised to provide funds for construction purposes, and a special staff of employes maintained for this sole purpose, it would seem quite legitimate that the interest paid on such loans, and the salaries of the special staff, should be charged to Construction Account until the work under construction is in full operation. Any other method might result in the creation of paper or fictitious profits, which would not be realized as long as the property was operated, and might never be realized on an ultimate sale thereof. A good instance is the case of a railroad building

large extensions, the material for which in considerable quantities is carried over its own road. The freight on this material forms part of the earnings of the road, and if the new construction bears a large proportion to the mileage in operation, the earnings will be swelled to abnormal proportions by the additional traffic so created, and the road will appear, for a short period to be earning profits entirely out of proportion to those derived from its normal operations. The whole of this increase is really fictitious and does not add to the value of the stock in any way.

"Managers of the operating departments of a factory frequently claim that they should be allowed to charge a profit on construction work carried out for their own mills, on the ground that if the work were done outside they would have to pay a profit, and at the same time would set free their own facilities to carry out additional work at a profit for outside customers; and they even go so far as to say that if they cannot charge a profit on construction work so carried out, they will in future have the work done on outside contracts. It must be admitted that this is a plausible argument, but a little further consideration will show that it is fallacious. There is here a confusion between a Profit and a Saving. The reason that a concern undertakes its own construction work in place of letting outside contracts therefor, is that it can by that means effect a saving in its expenditure, by taking advantage of its own capital and facilities to carry out the work instead of using the organization and the capital of others, upon which it would have to pay a profit. The saving so effected is of considerable advantage in that it reduces the amount of capital invested and future earnings will represent a larger return on the investment. Moreover, it is seldom true that the use of a corporation's own facilities for construction expenditure really means the throwing away of profitable work for outsiders, which would otherwise have been undertaken. It is doubtful if any well managed concern ever refuses profitable orders, because of its own construction work; its organization can and will, almost automatically, expand sufficiently to provide for any increase in its operations which is likely to be thrown upon it. Moreover, if a sum be added to the cost of construction and credited to profit and loss, to represent the profit which would have been earned by the Company if the work had been done for outsiders instead of for itself, this profit can only be made available for distribution by increasing the amount of capital contributed for new construction work; and it can hardly be considered good financial policy to increase indebtedness for the purpose of paying dividends. The only sound principle that can be adopted is to charge to construction all costs and expenses which are directly attributable to that construction, but nothing for indirect expenses, interest or profit."

REFERENCES:

Kester, Vol. II, pages 87-97

COMPLETE ACCOUNTING COURSE--PART II

Lecture 5

DEPRECIATION

Problem 13

A meeting of bondholders and creditors was held July 10, 1918, to consider the advisability of extending the indebtedness of the Miller Motor Car Co. so as to enable the company to recover from the fire which had destroyed the plant. After due consideration of the statement of affairs dated July 6, 1918, it was agreed to grant an extension of one year on condition that the stockholders raise $200,000 to be used for the immediate rebuilding of the plant.

On July 12, 1918, a meeting of the stockholders was held to consider the proposition submitted by the creditors. The stockholders expressed their inability to raise the required funds, whereupon by resolution duly passed it was resolved to dissolve the company. The Central Trust Company was requested to act as receiver.

August 6, 1918, the receiver reported as follows:

COLLECTIONS

Notes Receivable and accrued interest	$ 52,253.25
Accounts Receivable	49,480.22
Insurance Company--covering loss sustained on buildings, machinery, trucks, and fixtures	100,000.00
Salvage from machinery, tools, equipment, and fixtures	30,000.00
Salvage from inventories (merchandise stock was not insured)	10,000.00
Land, less commission	44,100.00
Investment	100,000.00

DISBURSEMENTS

Wages and taxes paid in full. The bonds were paid off together with interest amounting to	$ 5,850.00
Audited Vouchers	60,144.12
Expenses	9,842.78

Remaining assets are worthless and there are no further liabilities to be paid.

Prepare balance sheet, cash account, and statement showing results of the realization and liquidation to date and state what dividend (if any) may be expected by the stockholders.

Also prepare the journal entries to close the books of the Miller Motor Car Co., showing separately the loss by fire and the loss on liquidation of the business.

MISCELLANEOUS QUESTIONS

Question 21--What is your understanding of the following terms:
(a) Opening entries
(b) Closing entries
(c) Adjusting entries.

Question 22--What is your understanding of the following terms:
(a) Accrued Interest on Bills Receivable and Bills Payable.
(b) Insurance Unexpired.
(c) Rents Paid in Advance.

How should each of these items be classified in a balance sheet? Illustrate the character of items you would find in such accounts.

Question 23--A corporation which had its financial statements prepared for the year ending December 31, 1918, contemplates making a substantial addition to its reserve for depreciation as of December 31, 1918. What effect will this have on the various balance sheet accounts and how will working capital be affected?

Question 24--During an examination of the books of a certain company the following entries are submitted for your approval:

(1)		
Investment in other Companies (5% stock interest)	$10,000.00	
To--Dividends Received Account		$10,000.00
For proportion of estimated dividend expected to be paid on......... on the capital stock of the A Mfg. Co.		
(2)		
Property Account	15,000.00	
To--Surplus Account		15,000.00
To write up the book value of certain land and buildings per instructions of the general manager.		
(3)		
Depreciation Reserve	18,500.00	
To--Depreciation (Profit and Loss)		18,500.00
To write back the provisions for depreciation for the year 1918.		

What would be your comment in each case?

Question 25--Draft a form of cash book suitable for a trading concern that has two sales ledgers, accounts payable or voucher record, and a private ledger, all of which are balanced separately; the system to provide that (a) all receipts be deposited intact and (b) all disbursements be made by the use of a combination voucher-check.

Solution to Problem 7

A & B PARTNERSHIP
REALIZATION AND LIQUIDATION ACCOUNT
(Date)

ASSETS TO BE REALIZED:			LIABILITIES TO BE LIQUIDATED:		
Customers	$ 94,100		Mtge. Obligation	$125,000	
Inventories	95,250		Bills Payable	145,000	
Real Estate	33,000		Trade Creditors	95,000	$365,000
Buildings	96,000				
Machinery and Equipment	82,800		ASSETS REALIZED:		
Tools and Fixtures	13,250	$414,400	Customers	$ 82,000	
			Inventories	84,500	
LIABILITIES LIQUIDATED:			Real Estate, Buildings, Machinery and Equipment, Tools and Fixtures	130,000	296,500
Mtge. Obligation	$125,000				
Bills Payable	105,231				
Trade Creditors	68,944	299,175			
LIABILITIES NOT LIQUIDATED:			LOSS ON REALIZATION AND LIQUIDATION		118,400
Bills Payable	$ 39,769				
Trade Creditors	26,056	65,825			
EXPENSES		500			
		$779,900			$779,900

CASH ACCOUNT

Balance Carried Forward	$ 3,175	Expenses	$ 500
Customers	82,000	Bills Payable	105,231
Inventories	84,500	Trade Creditors	68,944
Property Assets	5,000		
	$174,675		$174,675

Solution to Problem 8

.................COMPANY
STATEMENT OF AFFAIRS
DECEMBER 31, 1918

Book or Cost Value	ASSETS		Expected To Realize	Gross Liabilities	LIABILITIES		Expected to Rank
	CURRENT ASSETS:				PREFERRED CLAIMS:		
$ 400	Cash		$ 400	$ 3,000	Wages Deducted--per contra		
152,000	Trade Accounts		102,500				
	Good	$ 85,000			FULLY SECURED CREDITORS:		
	Doubtful (50% good)	35,000		50,000	Bills Payable	$50,000	
	Bad	32,000			DEDUCT--Security held thereagainst (per contra)	$50,000	
		$152,000					
33,000	Notes Receivable		26,000				
	Good	$ 22,000					
	Doubtful (50% good)	8,000		50,000	First Mtge. 6% Bonds Deducted--per contra		-------
	Bad	3,000					
		$ 33,000					
					PARTIALLY SECURED CREDITORS:		
50,000	First Mtge. 6% Bonds			45,000	Trade Creditors	$45,000	
	DEDUCT--Bills Payable (per contra)	50,000	-------		DEDUCT--Value of Mdse.	30,000	$ 15,000
					UNSECURED CREDITORS:		
105,000	Inventory of Mdse. (less $30,000 per contra)		75,000	275,000	Trade Creditors	$275,000	
				4,800	Bank Overdraft	4,800	279,800
$340,400			$203,900	$427,800	Total Liabilities		$294,800

	PROPERTY ASSETS:					
$ 95,000	Real Estate, Bldgs. & Other Assets	$95,000				
	DEDUCT--First Mtge. 6% Bonds (per contra)	50,000	45,000			
$435,400	Total All Assets		$248,900			
	DEDUCT--Preferred Claims (per contra)		3,000			
	Net Free Assets		$245,900			
	Balance--Deficiency to Creditors		48,900			
			$294,800			$294,800
192,400	Deficiency per books Deficiency to Stockholders		$200,000	$200,000	Capital Stock	$200,000
$627,800			$200,000	$627,800		$200,000

DEFICIENCY ACCOUNT

Deficiency at January 1, 1919		$ 33,000		
Losses from Operations for the Fiscal Year Ending December 31:			Original Investment of Stockholders Represented in Capital Stock Issued and Outstanding	$200,000
1917	$80,050			
1918	39,350	119,400	Balance--Deficiency to Creditors as per Statement of Affairs	48,900
Dividends Declared and Paid		40,000		
Estimated Loss on the Realization of Assets--per Statement of Affairs:				
Notes Receivable	$ 7,000			
Ordinary Trade Accts.	49,500	56,500		
		$248,900		$248,900

Solution to Problem 9

JOURNAL ENTRIES

(1)

August Miller, Capital	$ 6,000.00	
To--Accommodation Paper		$ 6,000.00
To charge A. Miller with liabilities to be paid by the firm.		

(2)

Notes Receivable Discounted	10,000.00	
To--Notes Receivable		10,000.00
To transfer the credit from Notes Receivable Discounted Account to Notes Receivable Account.		

(3)

Realization and Liquidation Account	79,582.00	
To--Notes Receivable		100.00
Customers' Accounts		35,542.00
Merchandise Inventory		39,090.00
Miscellaneous Supplies		300.00
Delivery Equipment		1,750.00
Fixtures		1,450.00
Advances on Consignments-Inward		1,100.00
Unexpired Insurance		50.00
Rent Paid in Advance		200.00
To transfer assets to be realized to Realization and Liquidation Account.		

(4)

Taxes Accrued	200.00	
Notes Payable	10,000.00	
Accounts Payable	36,080.00	
Bank Loan	3,000.00	
Interest Accrued on Notes Payable	36.00	
Accommodation Paper	6,000.00	
To--Realization and Liquidation Account		55,316.00
To transfer liabilities to be liquidated to Realization and Liquidation Account.		

(5)

Cash		52,725.92	
To--Realization and Liquidation Account			52,725.92
Assets Realized:			
Customers' Accounts	$23,000.42		
Merchandise Inventory	26,500.50		
Miscellaneous Supplies	100.00		
Delivery Equipment	1,340.00		
Fixtures	785.00		
Advances	1,000.00		

(6)

Realization and Liquidation Account		$54,316.00	
To--Cash			$54,316.00
Liabilities Paid:			
Notes Payable	$10,000.00		
Accounts Payable	36,080.00		
Taxes Accrued	200.00		
Accommodation Paper	5,000.00		
Bank Loan	3,000.00		
Interest Accrued on Notes Payable	36.00		

(7)

Realization and Liquidation Account	1,544.70	
To--Cash		1,544.70
Expense paid.		

(8)

Realization and Liquidation Account	1,000.00	
To--Realization and Liquidation Account		1,000.00
Accommodation paper renewed.		

Solution to Problem 9

MILLER BROTHERS
Fred Miller, Receiver
REALIZATION AND LIQUIDATION ACCOUNT
JULY 2, 1918

ASSETS TO BE REALIZED:		
Notes Receivable	$ 100.00	
Customers' Accounts	35,542.00	
Merchandise Inventory	39,090.00	
Miscellaneous Supplies	300.00	
Delivery Equipment	1,750.00	
Warehouse & Office Fixtures	1,450.00	
Advances on Consignments-Inward	1,100.00	
Unexpired Insurance	50.00	
Rent Paid in Advance	200.00	$ 79,582.00
LIABILITIES LIQUIDATED:		
Notes Payable	$ 10,000.00	
Accounts Payable	36,080.00	
Taxes Accrued	200.00	
Accommodation Paper	5,000.00	
Bank Loan	3,000.00	
Int. Accrued on Notes Payable	36.00	54,316.00
LIABILITIES NOT LIQUIDATED:		
Accommodation Paper		1,000.00
EXPENSES OF REALIZATION AND LIQUIDATION (including Wages Accrued, $173)		1,544.70
		$136,442.70

LIABILITIES TO BE LIQUIDATED:		
Taxes Accrued	$ 200.00	
Notes Payable	10,000.00	
Accounts Payable	36,080.00	
Bank Loan	3,000.00	
Interest Accrued on Notes Payable	36.00	$ 49,316.00
ADDITIONAL LIABILITIES TO BE LIQUIDATED:		
Accommodation Paper		6,000.00
ASSETS REALIZED:		
Customers' Accounts	$23,000.42	
Merchandise Inventory	26,500.50	
Miscellaneous Supplies	100.00	
Delivery Equipment	1,340.00	
Fixtures	785.00	
Advances	1,000.00	52,725.92
BALANCE--Loss on Realization and Liquidation		28,400.78
		$136,442.70
Accommodation Paper Renewed		$ 1,000.00

MILLER BROTHERS
BALANCE SHEET
JULY 2, 1918

Cash	$ 642.06	Accommodation Paper	$1,000.00
Fred Miller, Capital	1,308.62	August Miller, Capital	950.68
	$1,950.68		$1,950.68

STATUS OF PARTNERS' ACCOUNTS

PARTICULARS	FRED MILLER	AUGUST MILLER	TOGETHER
Capital, April 30, 1918	$17,625.23	$16,417.61	$34,042.84
Accommodation Paper		$ 6,000.00	$ 6,000.00
Loss on Realization	$18,933.85	9,466.93	28,400.78
Total Deductions	$18,933.85	$15,466.93	$34,400.78
Capital, July 2, 1918	*$ 1,308.62	$ 950.68	*$ 357.94

*Red.

ANSWERS TO QUESTIONS

Answer to Question 11--The following is a list of the principal books of accounts usually kept by a firm or company:

General ledger
General journal
Audited voucher record
Cash book
Sales record
Goods returned record
Allowance register

The exact rulings and headings used would vary to a considerable extent according to the nature of the business.

Answer to Question 12--

(a) Book profits, briefly speaking, are unrealized profits and arise from the writing up of an asset; e.g., a piece of real estate purchased for, say, $25,000 is written up to $30,000, which presumably is the real value at the date the cost value was written up. The difference of $5,000 would be referred to as a book profit. The valuation of an inventory at a price in excess of cost would also create a book profit to the extent of the difference between cost and the inventory value as determined. "Book profits" is a technical term and has no relation to the term "profits as per books."

(b) Inventory reserves are reserves created out of profits for the purpose of providing for a possible loss on the sale of stocks of merchandise. Generally speaking, the need for such a reserve arises from a drop in the market price below the cost price of merchandise, and following out the accounting principle that inventories should be valued at cost or market, whichever is the lower, it becomes necessary to provide for this possible loss. Then again, finished products carried over from one season to another generally are disposed of at a sacrifice, and in such case it becomes necessary to make some provision for the probable loss on the realization of the stocks. The transactions that would enter into an Inventory Reserve account are illustrated thus:

INVENTORY RESERVE ACCOUNT

DEBIT WITH	CREDIT WITH
Total losses sustained on the realization of stocks of merchandise against which the reserve was credited--contra a credit to Merchandise or Stock accounts.	Total provision during the period for the estimated loss on the realization of the stocks of merchandise--contra a debit to Profit and Loss account.

(c) Contingent liabilities are liabilities which may become real liabilities under certain conditions.

<u>Answer to Question 13</u>--

The deduction of the credit balances from the asset of uncollected customers' accounts has the effect of understating the assets and liabilities respectively, which obviously is incorrect. There would be as much justification in deducting ALL liabilities from the assets and bringing down the net difference as representing the assets. The item in question is a liability and under ordinary circumstances would be discharged by (1) payment in cash or (2) a subsequent sale of goods to be applied in the reduction of the credit balances arising from allowances for defective goods, etc.

<u>Answer to Question 14</u>--

(a) Bad Debts Suspense, $13,103.93. From the title of the account it would appear that it is more or less of a doubtful nature, indeed, if not entirely irrecoverable. The facts would have to be ascertained and then full provision made for any possible loss on the realization of the accounts. The reserve created should, of course, be deducted from the assets so that the balance sheet would reflect the estimated realizable value of the accounts.

(b) President's Drawing account, $10,500. The carrying forward of such an account is rather unusual and apparently would call for special inquiry to determine (1) upon whose authority the moneys were advanced and (2) whether or not it is collectible. Generally speaking, the item should be set out separately under the general heading of Accounts Receivable as "Officers' Accounts."

(c) Consignment Stocks, $51,708.25, are part of the inventories and should not be classified among the Accounts Receivable. It is desirable, however,

that they be priced at cost and shown separately under the heading of Inventories, as follows:

Inventories:	
Finished Stock, Work in Progress, Raw Materials, etc.	$--------
Consignment Stocks	--------

(d) Working Funds, $1,250, undoubtedly represent the funds in the hands of cashiers for petty cash requirements and are, therefore, part of the cash resources if intact. The amount should be shown under the heading of cash, as "Cash on Hand" or "Working Funds."

Answer to Question 15--

BITTER HILLS CREAMERY CO.

Consignment No. 18673--

July	1	Freight	$ 123.50	July	14	Sales	47 1/2	$ 4,750.00
"	1	Cartage	45.75	"	20	Sales	48 1/3	5,800.00
"	20	Storage	39.45	"	20	Stock	48	1,440.00
"	25	Commission	1,199.00					
"	25	Cash Discount	105.82					
"	25	Check #4751	10,476.48					
			$11,990.00					$11,990.00

The above is a summary of the account sales that would be prepared for the consignor. An account sales and carbon copy may be headed up as soon as the consignment is received; this will serve as a ledger account to which charges and credits may be posted immediately. It is of prime importance that the consignments be posted up to date; hence, in such a business, ledgers are posted before journal entries are made. Controlling accounts are necessary, however, to verify clerical accuracy; for a discussion of these in connection with the keeping of consignment accounts, see Part I, Lecture 11.

DEPRECIATION

NATURE OF DEPRECIATION--Depreciation is the term applied to the loss in value of an asset due to wear and tear in use; lapse of time even though not in use; obsolescence or inadequacy due to the invention of substitutes, or change in design which renders the asset useless for the purpose for which it was acquired.

In Hatfield's "Modern Accounting" there is an excellent introduction to the chapter on depreciation and it might not be amiss to quote therefrom:

"Destruction is the law of nature. Fixed capital, using the term here in its economic rather than in its accounting sense, despite its name, is not

exempt from this law. Even so-called permanent improvements, such as buildings, are all subject to the ravages of time, which Marshall aptly defines as 'the complex of destructive agencies.' All machinery is on an irresistible march to the junk-heap, and its progress, while it may be delayed, cannot be prevented by repairs."

FACTORS DETERMINING AMOUNT OF DEPRECIATION--

1. ORIGINAL COST LESS SCRAP VALUE. The cost of an asset less the residuary scrap value constitutes the amount to be provided for.
2. DISMANTLING. In determining the residuary second-hand, scrap, or junk-value of an asset allowance must be made for the expense incidental to the removal of the old asset when the replacement occurs.
3. LIFE. The original cost less scrap value should be charged off within the estimated time during which that asset may be used in operation.
4. REPAIRS. The estimated life of an asset depends to a material extent on the character of the periodical repairs.
5. USE. The estimated life of an asset depends to a material extent on the manner in which it is used.

METHODS OF PROVIDING FOR DEPRECIATION--

1. A FIXED PERCENTAGE APPLIED ON A FLAT BASIS. If the estimated life be ten years, one-tenth of the estimated depreciation should be charged off annually.

2. A FIXED PERCENTAGE APPLIED ON THE DIMINISHING VALUE. A rate is ascertained which if applied on the original cost and on the balance remaining after applying the periodical provision for depreciation will at the end of its estimated life reduce the book value of the asset to its estimated scrap value.

3. SINKING FUND OR ANNUITY. An amount is periodically set aside, the aggregate of which, together with the accumulated interest, will equal the estimated depreciation to be provided for during the estimated life of the asset.

4. PRODUCTION. The periodical provision for depreciation may be based on the production during the current period, and during the estimated life of the asset, the total amount provided for should be sufficient to reduce the book value of that asset to its estimated scrap value. This method is adapted to cases where the depreciation accruing bears a close relation to the volume of production. As applied, there is generally a minimum and maximum to the provision to be made in any one period.

5. REVALUATION. The asset is revalued each year and the difference disclosed by the revaluation is transferred to the current year's operations. This method generally speaking is not a practical one, unless elaborate property records are kept, and very few companies are willing to incur the expense incident to keeping such records. So far as small tools, horses, etc., are concerned it is considered the preferable method of providing for depreciation as it tends to distribute more equitably the loss in value against each year's operations.

6. ARBITRARY AMOUNT. In many cases the provision for depreciation is not scientifically determined. The amount is estimated by the Board of Directors and is represented by an appropriation of profits at the end of the year. When it is deemed desirable to reduce the surplus profit for any period a large provision may be made for depreciation; and vice versa, where a large profit showing is desired, the depreciation provision may be reduced or omitted. This method, therefore, is objectionable since it permits manipulation of the periodical profit and loss statement.

ILLUSTRATION--Montgomery illustrates in the following table the variations in the annual provision for depreciation under the first three methods, assuming the cost value of an article is $1,000; its estimated scrap value $100; and its estimated life ten years.

Year	Fixed Percentage Method--10% on Original Value	Fixed Percentage Method--20.57% on Diminishing Value	Sinking Fund Method--At 5% Compound Interest
1	$ 90.00	$205.70	$ 71.55
2	90.00	163.38	71.55
3	90.00	129.78	71.55
4	90.00	103.08	71.55
5	90.00	81.88	71.55
6	90.00	65.03	71.55
7	90.00	51.66	71.55
8	90.00	41.03	71.55
9	90.00	32.59	71.55
10	90.00	25.87	71.55
			$715.50
Compound Interest at 5%			184.50
Totals	$900.00	$900.00	$900.00

DEPRECIATION RATES--No definite depreciation rates can be given, as this must be determined by the character of the property and the manner in which it is used and repaired. Some rates in general use are:

1. Buildings, 1-1/2% to 5% per annum
2. Machinery, 5% to 10%
3. Furniture and fixtures, 10% to 15%
4. Horses and wagons, 10%--Revaluation preferable
5. Tools, 20% to 33-1/3%--Revaluation preferable
6. Electrical lighting plants, 4% to 5%
7. Water pumping plants, 3/4% to 1-1/2%

IS DEPRECIATION AN OPERATING EXPENSE?--If the depreciation provision is so calculated as to represent the approximately correct charge for the period, the better practice is to include same as a manufacturing expense. But where the provision represents an arbitrary appropriation which may be grossly

excessive or deficient, it would seem that the better practice is to exclude it from the manufacturing account and show the item as a deduction from the general profit and loss.

In estimating the cost of production there must be considered not merely material, wages, and production expenses, "but in addition some allowance must be made for the diminished value of the fixed assets due to gradual loss of serviceability. Consequently profits are not determined until after allowance has been made for depreciation. Depreciation is not a disposition of part of the profits, but an expense without which profits can never be earned." (Hatfield.)

If the life of the asset is taken as the fiscal period no one would claim that the cost value of the asset worn out in producing the finished product was not part of the cost of such product. Where the fiscal period is less than the life of the asset, the depreciation provision is merely a method of distributing this element of cost over the fiscal years during which the asset was used.

The position of the Interstate Commerce Commission is indicated by the following extract:

"When carried to its final analysis the question of formal depreciation charges to operating expenses is simply a question of what constitutes cost of operation, and the time when such cost shall be acknowledged in the accounts. The position which the Interstate Commerce Commission's system of accounts assumes on this point is that the depletion which represents an investment through the use of that asset in operation creates an item of cost of operation which should be reflected in the accounts when the fact of such depletion takes place, and that a statement of net revenue made without including this element of cost in operating expenses is an erroneous statement."

DEPRECIATION RESERVE--The depreciation reserve is a valuation account and on the balance sheet is deducted from the corresponding asset. But where the amount accrued is grossly excessive or deficient, it is oftentimes shown on the balance sheet under the heading of Reserves.

Sometimes a single depreciation reserve is kept. Where the depreciation provision is determined on a scientific basis it is preferable to maintain a series of depreciation reserves corresponding to the classification of the assets being depreciated.

The elements entering into a depreciation reserve account are as follows:

DEPRECIATION RESERVE ACCOUNT

DEBIT WITH	CREDIT WITH
Extraordinary renewals or periodical renewals which tend to increase the original life of the asset. (Ordinary repairs and renewals must be absorbed in the operating expenses of the period in which the expenditure is incurred.)	Periodical provision for accrued depreciation--contra a charge to Operating Expenses.
Cost value of asset dismantled--contra a credit to corresponding property account.	Scrap value of asset dismantled--contra a charge to Scrap Stock account.

The balance of the account represents accrued depreciation not made good.

AMOUNT OF DEPRECIATION TO BE ACCUMULATED--In this connection the following extract from Mr. Dickinson's paper, "Profits of a Corporation," may be of interest:

"It would be beyond the scope of this paper to discuss what the different rates of depreciation on different classes of property should be, but it is necessary to emphasize the fact that however long the life of the buildings or plant, and however much may be spent year by year in the actual upkeep thereof, there must be a gradual depreciation in value, due either to direct wear and tear or to the necessity of replacing old and obsolete articles by new and up-to-date ones. It is probable, however, that in any going concern which is maintained in an efficient condition there is a limit to the total amount of this depreciation as between original cost and present value; in fact, the theory that any piece of machinery or any building continues in use until it reaches an absolute scrap value is not in accord with practical experience, taking any plant as a whole. When the plant is entirely new it may properly be considered as being worth its cost. It will never again attain this standard, because never again will the whole of it be absolutely new; on the other hand, it can never fall below a certain percentage of this standard without becoming so inefficient that it could not be operated at all.

"Between these limits, therefore, would seem to lie the total amount of depreciation to be provided out of earnings over a long period of years, assuming that all renewal expenditure tending to increase the life of the plant is charged against the depreciation so provided. It is submitted that perhaps the most satisfactory way of making such provision is in the first instance to estimate the life of the different assets, assuming that ordinary recurring maintenance and renewal charges are provided out of profits as they occur, and to set aside each year the corresponding proportion of the original cost, crediting the same to a depreciation fund. From time to time expenditures which may be termed 'extraordinary renewals' or 'periodical renewals' will require to be made, which from their nature increase the original life of the plant. These should be charged against the fund provided. In this manner an equitable charge would be made against earnings each year to represent the amount of wear and tear that has accrued during the year.

"In many cases, in place of a basis of life in years, one in tons operated will be found preferable, in which case the charge against profits would take the form of a rate per ton of production rather than a rate per year of life. There are other methods in force for properly providing for this wear and tear but there is one method which it may safely be stated is an entirely erroneous one, and that is to set aside such sums as the directors may decide upon out of the profits of each year upon no definite basis whatever. A decision as to the period at which the necessary charge should be made against profits must be admitted to be largely within the discretion of the managers, for the reason that they have to consider not only sound principles of accounting, but also policy; but it is not inconsistent with this proposition, and is certainly more scientific, to adopt a sound and conservative basis in the first instance and create in the books a subsidiary suspense account of the proper amount each year which would be discharged by appropriations made from time to time out of surplus profits. Such a course is however, at best,

a makeshift and it is the duty of all Accountants, though they cannot compel, at least to urge, corporations to make adequate provision for depreciation each year."

REFERENCES:

Nicholson and Rohrbach, Chapter X
Kester, Vol. II, Chapters VIII to XI
Leake, pages 67-135

COMPLETE ACCOUNTING COURSE--PART II

Lecture 6

ANALYSIS OF PROFITS

Problem 14

The following trial balances have been abstracted from the books of the firm of F and G at the close of business on December 31, 1918, and June 30, 1919, respectively:

	DECEMBER 31, 1918		JUNE 30, 1919	
F--Capital Account		$ 23,983.27		$ 23,983.27
G-- " "		17,093.27		17,093.27
F--Drawing Account	$ 900.00		$ 1,800.00	
G-- " "	1,100.00		1,700.00	
Real Estate and Buildings	30,913.27		30,083.27	
Tool Equipment	1,507.04		1,903.23	
Machinery and Other Equipment	12,091.07		19,093.09	
Customers' Accounts	39,027.09		51,027.03	
Raw Materials on Hand, July 1, 1918	9,027.03		9,027.03	
Notes Receivable	345.01		4,705.27	
Cash	11,987.05		12,403.24	
Accounts Payable		26,098.18		17,091.07
Bills Payable		7,500.00		9,000.00
Wages	9,988.91		18,946.25	
Raw Materials Purchased	9,183.91		21,566.00	
Taxes	341.55		788.44	
Heat and Power	1,403.27		2,904.83	
Factory Expense	818.17		1,904.32	
Salesmen's Salaries and Traveling Expenses	3,981.93		7,118.92	
Insurance Premiums	451.05		782.03	
Office Expenses	783.45		1,604.32	
General Traveling Expenses	905.40		1,107.35	
Interest (net)	984.50		709.82	
Sales (less Returns and Allowances		59,276.05		120,599.75
Rents Collected and Other Miscellaneous Income (less sundry deductions)		1,788.93		1,407.08
	$135,739.70	$135,739.70	$189,174.44	$189,174.44

The firm commenced operations on July 1, 1918; and the books were properly opened on that date. The books were not closed, however, on December 31, 1918, and the partners are particularly anxious to be informed of the results from operation for the first six months of the partnership. From the best information available at the latter date the following items should be taken into account in arriving at the financial situation at December 31, 1918, and the profits for the six months ending on that date:

1. Inventory of--Raw Materials	$ 989.11
Finished Products	1,575.83
2. Accrued Interest on--Bills Receivable	78.98
Bills Payable	175.84

3. According to the partnership agreement each partner's capital account should be credited with interest at 6% per annum, computed semiannually on the balance at the beginning of each six months' period.
4. Profits or losses to be shared equally by the partners.

So far as the accounts for the six months ending June 30, 1919, are concerned, it will be necessary to take the following items into consideration:

1. Inventory of--Raw Materials	$1,108.37
Finished Products	1,835.07
2. Accrued Interest on--Bills Receivable	135.34
Bills Payable	184.07

3. The stipulation in the partnership agreement with respect to interest on the partner's capital accounts and the division of Profits and Losses.

With the foregoing information before you prepare:

(a) Comparative statement of profits and income for each of the two six-month periods above referred to.
(b) Balance sheet at June 30, 1919.
(c) Statement of causes of increases and decreases in profit and loss accounts of December 31, 1918, and June 30, 1919.

MISCELLANEOUS QUESTIONS

Question 26--In connection with corporation accounting the following terms are used. What is your understanding of them?

(a) Fixed charges
(b) Replacement expenditures
(c) Maintenance expenditures

Question 27--What are capital assets? At a meeting of shareholders of a company, you, as auditor, are asked to explain why you have signed the Balance Sheet in which the capital assets appear at amounts in excess of what they would realize if sold. What would be the nature of your reply?

Question 28--How should the following expenditures be distributed in the accounts of a manufacturing company?

(a) Additions and extensions to property, $98,102.15
(b) Extraordinary repairs and renewals (assuming that adequate provision has been made for depreciation), $18,027.11
(c) Ordinary repairs and renewals, $27,081.33
(d) Replacement of certain equipment (estimated original cost, $81,047.27; salvage recovered, $9,818.28), $125,091.27

Question 29--Formulate the entries in respect to the following:

(a) Cost value, $101,000, of certain buildings torn down during the year and replaced by other buildings costing $175,000. The value of the salvage recovered from the old buildings amounted to $10,000.
(b) Heavy repairs and extraordinary renewals of machine shops equipment, tending to prolong the life of the equipment, $31,093.87.

Question 30--How should the following items be distributed in the books of a manufacturing company?

(a) Expenditures of $11,383.11 in repair and renewal of soap-making machinery and equipment. The original cost of the machinery repaired and renewed was $65,000.
(b) Advance of $5,000 (first six months' salary) to John Smith, who had just been appointed manager of one of the principal European offices.
(c) Expenditure of $25,000 in improving machine shop equipment for the purpose of reducing the cost of production.

Solution to Problem 10

THE MILLER MOTOR CAR COMPANY
STATEMENT OF AFFAIRS
JULY 6, 1918

ASSETS

Book Value			Expected to Realize
	CURRENT ASSETS:		
$ 50,186.45	Cash		$ 50,186.45
500.00	Petty Cash Fund		500.00
116,003.00	Notes Receivable:		
	Good	$ 25,000.00	25,000.00
	Doubtful (30%)	50,000.00	15,000.00
	Bad	41,003.00	
		$116,003.00	
315.92	Accrued Interest on Notes Receivable		212.50
100,690.65	Accounts Receivable:		
	Good	$ 30,000.00	30,000.00
	Doubtful (50%)	30,000.00	15,000.00
	Bad	44,013.40	
		$104,013.40	
	LESS--Reserve for Bad Debts and Discounts	3,322.75	
		$100,690.65	
82,486.63	Inventories (destroyed by fire)--salvage estimated at		10,000.00
$350,182.63			$145,898.95
	DEFERRED CHARGES:		
$ 2,000.00	Advances to Salesmen		
766.66	Unexpired Insurance		
100.00	Rent Paid in Advance		
2,000.00	Discount on Stock		
$ 4,866.66			

	CAPITAL ASSETS:		
$ 69,800.00	Buildings	$ 69,800.00	
163,390.14	Machinery and Equipment	163,390.14	
1,706.24	Delivery Equipment	1,706.24	
2,027.52	Fixtures	2,027.52	
	Total Property Assets Destroyed by Fire	$236,880.14	
	Salvage	$ 30,000.00	
	Fire Insurance Carried	100,000.00	
40,000.00	Land	45,000.00	
		$175,000.00	
	DEDUCT--Due Bondholders (per contra)	229,825.00	
66,000.00	Good-will		
200,000.00	Investment in Durant Truck Company		100,000.00
$542,923.90			
$897,973.21	Total All Assets		$245,898.95
	DEDUCT--Estimated Expense of Realization and Liquidation	$12,500.00	
	Preferred Creditors--per contra	43,944.89	56,444.89
	Net Free Assets		$189,454.06
	Surplus of Net Free Assets over Unsecured Claims carried down		$ 74,484.94
	Deficiency to 7% Preferred Stock Issued		25,515.06
	Deficiency to Common Stock Issued and Outstanding		464,259.20
$897,973.21			$564,259.20

LIABILITIES

Gross Liabilities			Expected to Rank
	PREFERRED CREDITORS:		
$ 41,649.55	Wages	$ 41,649.55	
2,295.34	Taxes	2,295.34	
	Deducted (per contra)	$ 43,944.89	
	PARTLY SECURED CREDITORS:		
150,000.00	5% First Mortgage Bonds	$150,000.00	
75,000.00	6% First Mortgage Bonds	75,000.00	
4,625.00	Accrued Bond Interest to June 30, 1918	4,625.00	
	Bond Interest Accrued from June 30, 1918, to July 6, 1918	200.00	
		$229,825.00	
	DEDUCT--Due from Insurance Company	$100,000.00	
	Salvage	30,000.00	
	Land	45,000.00	
	Total--per contra	$175,000.00	$ 54,825.00
	UNSECURED CREDITORS:		
60,144.12	Audited Vouchers		60,144.12
	Total All Liabilities		$114,969.12
	Surplus of Net Free Assets over Unsecured Claims		74,484.94
			$189,454.06
$100,000.00	7% Preferred Stock		$100,000.00
433,900.00	Common Stock Issued and Outstanding		433,900.00
30,359.20	Surplus		30,359.20
$897,973.21			$564,259.20

DEFICIENCY ACCOUNT

Estimated Loss in value of Assets on Realization:			Appreciation in Value of Land		$ 5,000.00
Notes Receivable	$76,003.00		7% Preferred Stock	$100,000.00	
Accrued Interest on Notes Rec.	103.42		LESS--Surplus to Creditors, as per Statement of Affairs	74,484.94	25,515.06
Accounts Receivable	55,690.65		Common Stock Issued and Outstanding		433,900.00
Advances to Salesmen	2,000.00		Surplus at June 30, 1918		30,359.20
Rent Paid in Advance	100.00				
Discount on Stock	2,000.00				
Good-will	66,000.00				
Investment	100,000.00	$301,897.07			
Fire Loss:					
Inventories	$82,486.63				
Buildings	69,800.00				
Machinery & Equipment	163,390.14				
Delivery Equipment	1,706.24				
Fixtures	2,027.52				
Unexpired Insurance	766.66				
	$320,177.19				
LESS--Insurance Recovered and Salvage	$140,000.00	180,177.19			
Bond Interest, July 1 to 7		200.00			
Expenses of Realization & Liquidation		12,500.00			
		$494,774.26			$494,774.26

Dividend to Preferred Stockholders--approximately 74.48%.

Solution to Problem 11

A CORPORATION
Organized under the Laws of
THE STATE OF ILLINOIS
With an Authorized Capital Stock of
$2,000,000.00
Divided into 20,000 Shares, Par Value $100.00 each

(1)

Subscriptions	$2,000,000.00	
To--Capital Stock		$2,000,000.00
To record subscriptions to authorized issue as per subscription list.		

(2)

Cash	1,700,000.00	
To--Subscriptions		1,700,000.00
Cash received in payment of subscriptions as per detailed list on file.		

(3)

Real Estate, etc.,	300,000.00	
To--A--Vendor Account		300,000.00
To record property received in payment of subscriptions as per bill of sale dated .... See also resolution of Board of Directors adopted .... (Minute Book page ....)		

(4)

A--Vendor Account	300,000.00	
To--Subscriptions		300,000.00

Solution to Problem 12

(1)

Unissued Common Stock	$1,000,000.00	
Unissued Preferred Stock	1,000,000.00	
To--Common Stock Authorized		$1,000,000.00
Preferred Stock Authorized		1,000,000.00
To record authorized increase in c apital stock as per resolution of the board of directors held on		

(2)

Stock Dividend (to be carried to Surplus)	1,000,000.00	
To--Unissued Common Stock		1,000,000.00
Dividend of 50% on outstanding capital stock declared by board on .... to stockholders of record ...., payable		

(3)

Cash	$800,000.00	
To--Unissued Preferred Stock		$800,000.00
Sale of 8,000 shares at par to common stockholders.		

(4)

Cash	242,000.00	
To--Unissued Preferred Stock		200,000.00
Premium on sale of Preferred Stock		42,000.00
Sale of 2,000 shares at 121.		

ANSWERS TO QUESTIONS

Answer to Question 16--Deferred charges represent a part or the whole of expenditures incurred in one period, the benefit from which accrues to a subsequent period and hence properly can be carried forward at the close of the period in which the expenditure was made as a deferred charge against future operations. By the use of deferred charge accounts prepaid expenditures can be properly allocated to the period to which they relate.

The following items among others are regarded as deferred charges:

1. Prepaid interest or discount on bills payable
2. Organization expenses
3. Insurance premiums prepaid.
4. Rent paid in advance
5. Stripping and development expenditures

If the deferred charge will be disposed of through charges to operating expense as in (3) or (4) it is termed a Deferred Charge to Operations. If it will be charged direct to the general profit and loss account or to surplus as in (1) or (2) it is termed a Deferred Charge to Income.

Answer to Question 17--Notes Receivable Discounted represent notes received from customers, etc., which after endorsement have been sold or otherwise disposed of before payment. The individual, firm, or corporation discounting the note is usually required to endorse same and thus guarantee its payment in event the maker should fail to pay the note at maturity. Until the note is redeemed by the maker it is a contingent liability of the party discounting the note. Contingent liabilities should be disclosed on the face of the balance sheet. In the case of Notes Receivable Discounted it is usually covered in a foot note reading thus:

"Contingent Liability in respect of Notes Receivable Discounted, $-------"

Another method is to deduct the Notes Receivable Discounted from the gross notes receivable, extending the net amount in the current asset column.

The entries required to be made in respect of Notes Receivable Discounted are as follows:

(1)

Cash	$--------	
Discount Prepaid	--------	
To--Notes Receivable Discounted		--------
For amount of notes discounted.		

(2)

Notes Receivable Discounted	--------	
To--Notes Receivable		--------
For amount of notes taken up by the makers on maturity.		

In the event the notes are not taken up on maturity the following entry would be made:

Notes Receivable Discounted	$--------	
(Party from whom received)		
To--Cash		$--------
For payment in respect of notes previously discounted and not taken upon maturity by maker.		

Answer to Question 18--

(a) Provision or Reserve for Bad and Doubtful Accounts is an amount set aside out of profits to provide for the estimated loss on the realization of accounts and notes receivable at any given date. The transactions that would ordinarily enter into such an account are set out in the following illustration:

RESERVE FOR BAD AND DOUBTFUL ACCOUNTS

DEBITED WITH	CREDITED WITH
Total amount of bad debts written off--contra a credit to the Customers' Accounts carried either in the customers' ledger or in the suspense ledger to which it had been temporarily transferred pending the final disposition of the account.	Total provision for bad and doubtful accounts during the period--contra a debit to Bad and Doubtful Accounts (profit and loss account). Recoveries on account of bad debts previously written off as irrecoverable.

The balance of the account is the reserve for bad and doubtful accounts at the end of the period, or the estimated loss on the realization of the uncollected accounts and notes receivable at that date.

(b) Accrued taxes represent the amount of taxes accrued but not due at a certain date. The transactions entering into such an account are shown thus:

ACCRUED TAXES ACCOUNT

DEBIT WITH	CREDIT WITH
Periodical payments in respect of personal or real property, franchise, income, and other taxes levied by states, counties, municipalities, or the federal government--contra a credit to Audited Vouchers or Accounts Payable.	Provision for accrued taxes during the period, usually based in the case of all taxes other than income tax, on those paid for the previous tax year or period.
Net debit adjustment in respect of excess provision for taxes--contra a credit to Taxes Account (profit and loss account).	Refunds on account of overpayment of taxes.
	Net credit adjustment in respect of short provision for accrued taxes.

The balance of the account is the accrued taxes at the end of the period.

(c) Accrued Wages represent the wages accrued from the date of the last pay-roll to the close of the period. The following is an illustration of the entries recorded in an Accrued Wages Account:

ACCRUED WAGES ACCOUNT

DEBIT WITH	CREDIT WITH
With the reversal as of the first of the next month of the entry referred to on the opposite side--contra a credit to Wages Account.	Provision for accrued wages at the end of a period--contra a debit to Wages Account.

As regards stating the various items in a balance sheet, they should be shown as follows:

1. Reserves for (a) bad and doubtful accounts, (b) discounts to be allowed, and (c) freight allowances to be made, should be deducted from the accounts receivable in order to state the asset at the estimated realizable value.

2. Accrued wages and taxes should be included among the current liabilities and shown separately. Another method of stating these items is to include them under a separate and general heading of "Accrued Liabilities."

Answer to Question 19--Expenditures in connection with additions and extensions to property made with the object of increasing the earning capacity of the plant may be defined as capital expenditures and can therefore be charged against the capital asset accounts. Expenditures in connection with the repair, maintenance, and upkeep of a property--or what are also termed ordinary repair, renewal, and replacement charges, and which do not result in either increased capacity or saving in operating expenses--are chargeable against the period in which the expenditures were incurred.

Answer to Question 20--

(a) The repair expenditures of $8,110.17 in connection with the repair of buildings, machinery, and other equipment are proper charges to the operating

expenses of the year in which the work was undertaken. All expenditures in the nature of ordinary repairs and renewals must be met out of the income of the period in which the work was done.

(b) The purchase of horses, wagons, and stable equipment at a cost of $11,000 is a proper charge against the Horses, Wagons, and Stable Equipment Account, but only in the event that adequate provision is made in respect of the depreciation which has already taken place on existing equipment. The amount of the depreciation should be ascertained and proper adjustment made between the Surplus Account at the beginning of the year and the Profit and Loss Account for the year.

ANALYSIS OF PROFITS

One method of analyzing financial statements is by comparison with financial statements of previous periods. In many cases the desired results may be secured by comparison with the next preceding period. The cause of changes in sales, cost of sales, and other profit and loss items may be summarized as shown below. Comparative balance sheets are the basis for the statement of application of funds which is described in Lecture 14.

M N COMPANY
COMPARISON OF STATEMENTS OF PROFIT AND LOSS
YEARS ENDING DECEMBER 31, 1917, AND DECEMBER 31, 1918

	1917		1918		INCREASE OR DECREASE*	
Particulars	Amount	%	Amount	%	Amount	%
Net Sales	$200,000.00	100.00	$250,000.00	100.00	$50,000.00	----
Less--Cost of Sales	150,000.00	75.00	180,000.00	72.00	30,000.00	*3.00
Gross Profits from Sales	$ 50,000.00	25.00	$ 70,000.00	28.00	$20,000.00	3.00
Less--Selling Expenses	$ 12,000.00	6.00	$ 16,000.00	6.40	$ 4,000.00	0.40
Genl. & Adm. Expenses	17,000.00	8.50	20,000.00	8.00	3,000.00	*0.50
Total Expenses	$ 29,000.00	14.50	$ 36,000.00	14.40	$ 7,000.00	*0.10
Net Profits from Operations	$ 21,000.00	10.50	$ 34,000.00	13.60	$13,000.00	3.10
Additional Interest Received	3,000.00	1.50	1,200.00	.48	*1,800.00	*1.02
Surplus Net Profits	$ 24,000.00	12.00	$ 35,200.00	14.08	$11,200.00	2.08

The causes of increases and decreases may be further analyzed by determining the factors affecting gross profit and setting out the principal items under selling and general and administrative expenses which have changed during the year. It is assumed that the unit selling price of the article manufactured by the M N Company has remained unchanged and that economies in production have been effected. We may, therefore, summarize as follows:

Increase in gross profits due to increases in sales (25.00% of $50,000)		$12,500.00
Increase in gross profits due to proportionate decrease in cost of sales (3.00% of $250,000)		7,500.00
Total increase in gross profits		$20,000.00
Less--Increase in salesmen's commissions proportionate to increase in sales)	$2,500.00	
Increase in salesmen's salaries	1,400.00	
Increase in officers' salaries	2,400.00	
Increase (net) in other expenses	700.00	7,000.00
Increase in net profits from operation		$13,000.00
Less--Decrease in interest received, due to increase in use of trade acceptances		1,800.00
Increase in surplus net profits		$11,200.00

The method shown above of analyzing gross profits is a useful one to apply in many cases. Where the increase or decrease in sales is caused by price changes, further analysis may be desirable. Thus, in the above illustration, assuming that 2,500 units were sold in 1917 and 3,200 units in 1918, the average gross profit per unit in 1917 would have been $20, and in 1918, $21.87½:

Each unit (average)	1917	1918
Sold for	$80.00	$78.125
Cost	60.00	56.250
Yielded Gross Profit of	$20.00	$21.875

The analysis would then appear as follows:

Increase in gross profits due to number of sales made ($20 x 700)	$14,000.00
Decrease in gross profits due to decrease in selling price ($1.875 x 3,200)	6,000.00
Increase in gross profits due to increase in sales	$ 8,000.00
Increase in gross profits due to proportionate decrease in cost of sales ($3.75 x 3,200)	$12,000.00
Total increase in gross profits	$20,000.00

Some of the causes of increase (or decrease) in gross profits may be found in the following:

1. Increase in sales volume due to
    (a) Increased turnover (or increased rate of production), or
    (b) Same turnover with larger inventory (or same rate of production with greater plant facilities)
2. Increase in sales price per unit sold.
3. Decrease in cost of sales due to definitely ascertainable causes.
4. Increase in cost of sales the ratio of which to sales has decreased.

Where the output cannot be departmentized by units sold, the analysis of gross profit fluctuations is of course much more difficult of ascertainment and cannot be set out in summary form.

COMPLETE ACCOUNTING COURSE--PART II

Lecture 7

RECEIVERSHIPS

Problem 15

A, B, and C were in partnership on the terms that A was to share one-half, and B and C one-fourth each, of the profits or losses.

On date of the dissolution the following statement of the assets and liabilities was abstracted from the books:

ASSETS		LIABILITIES		
Sundry Assets	$40,000.00	Partners' Capital Accounts:		
		A	$10,000.00	
		B	10,000.00	
		C	6,000.00	
		Total		$26,000.00
		Sundry Creditors		14,000.00
Total Assets	$40,000.00	Total Liabilities		$40,000.00

The assets realized $34,000, which was received in the following instalments: $14,000, $10,000, and $10,000.

How would you apply the proceeds from the realization of the assets as and when received? Prepare realization and liquidation account and entries to close books.

Problem 16

The following trial balance was abstracted from the books of Henry Parker, Receiver for the Ashton Manufacturing Company, on December 31, 1918 (date of receivership, July 1, 1917):

Cash	$ 5,650.00
Accounts Receivable	12,140.00
Raw Materials Inventory, December 31, 1918	38,400.00
Finished and Partly Finished Goods, December 31, 1918	26,120.00
Additions to Machinery and Equipment	10,000.00
Factory Expenses (including Labor)	198,450.00
Materials used in cost of sales	88,800.00
General and Selling Expenses	41,100.00
Bond Interest Paid--Ashton Manufacturing Co.	3,000.00

Liabilities Paid--Ashton Manufacturing Co.	$ 1,875.00	
Receiver's Expenses, 1918	7,880.00	
Ashton Manufacturing Co.--in Receivership		$ 3,415.00
Accounts Payable		30,800.00
Accrued Interest on Receiver's Certificates		1,200.00
Receiver's Certificates (forty $1,000 notes sold July 1, 1918, at 90; due July 1, 1920 at par; interest at 6%)		36,000.00
Sales, 1918		358,000.00
Reserve for Depreciation, 1917		4,000.00
	$433,415.00	$433,415.00

On the same date a trial balance of the Ashton Manufacturing Company's general ledger appeared as follows:

Real Estate	$ 75,000.00	
Machinery and Equipment	70,000.00	
Bond Interest	3,000.00	
Henry Parker, Receiver		$ 1,460.00
Reserve for Depreciation, to July 1, 1917		16,500.00
Accounts Payable		440.00
First Mortgage Bonds (due July 1, 1917; interest 6%)		50,000.00
Accrued Interest on above		1,500.00
Reserve for Premium on Bonds (bonds to be redeemed at 110)		5,000.00
Capital Stock, issued and outstanding		80,000.00
Surplus, balance January 1, 1918	6,900.00	
	$154,900.00	$154,900.00

Depreciation on Buildings, Machinery and Equipment for 1918, $9,000.

Prepare a balance sheet and a statement of profit and loss which you might expect to find in the receiver's report, consolidating the items on the receiver's and corporation's books.

Problem 17

A & B purchased a piece of property for $250,000, subject to a mortgage obligation of $150,000, the balance of the purchase price being paid in cash, which was advanced by A & B in equal proportions. In addition to these moneys, A & B each contributed $2,500 as working capital and paid out of that sum $3,000 for expenses in connection with the acquisition of the property.

The agreement entered into between A & B provided that A should collect the rents and transact all business and that the profits should be divided in the proportion of two-thirds to A and one-third to B.

The property was sold at the end of two years for $310,000, the purchaser agreeing to assume the mortgage of $150,000 (above referred to) and paying the

remainder in cash. During the two years the rents and profits were exactly sufficient to meet the interest on the mortgage obligations, except as to the item of $3,000 above referred to. A & B had not drawn anything.

State how the proceeds of the sale and the bank balance should be apportioned between A & B, as well as how to formulate the journal entries that are required to give expression to all of the foregoing transactions.

MISCELLANEOUS QUESTIONS

Question 31--Define the term "perpetual inventories." Are there any advantages in keeping inventories in this way and what steps are usually taken to verify such inventories?

Question 32--How should inventories of (a) finished products, (b) goods in process of manufacture, and (c) raw materials, be valued for the purposes of a balance sheet at any given date?

Question 33--A certain manufacturing concern makes tools and other equipment for use in its own plant and charges the same to the Capital Asset Accounts at the market value (which is in excess of cost) and credits the difference between the market and the cost value to Profit and Loss of the period in which the tools and other equipment were manufactured. Have you any criticism to make of this treatment in the accounts?

Question 34--In the preparation and certification of a balance sheet of a certain company would you think it necessary to take any cognizance of the following:

(a) Guaranty of the faithful performance upon the part of another company of a contract calling for the construction of a plant to cost $150,000. The first named company proposes to furnish the bulk of the steel and iron material required.

(b) Suit brought by an employee for $25,000 on account of injuries sustained while in the employ of the company. It is the opinion of the company's attorneys that a settlement could be effected for $10,000.

Question 35--

(a) Contrast the leading methods of providing for depreciation.

(b) If a company refused to make any provision for depreciation, in what way, if any, would you change the balance sheet; statement of profits and income?

Solution to Problem 13

JOURNAL ENTRIES

(1)

Reserves for Depreciation of:			
Buildings		$ 200.00	
Machinery, Tools, and Equipment		2,213.36	
Delivery Equipment		43.76	
Office and Warehouse Fixtures		17.48	
To--Buildings			$ 200.00
Machinery, Tools, and Equipment			2,213.36
Delivery Equipment			43.76
Office and Warehouse Fixtures			17.48
To close reserves for depreciation accounts on destruction of respective assets by fire, July 1, 1918.			
(2)			
Fire Loss		320,177.19	
To--Buildings			69,800.00
Machinery, Tools, and Equipment			163,390.14
Delivery Equipment			1,706.24
Office and Warehouse Fixtures			2,027.52
Inventory of Automobiles			30,550.00
Inventory of Finished Parts			18,463.72
Inventory of Work in Progress			26,132.11
Inventory of Raw Materials			3,740.80
Inventory of Coal			3,500.00
Inventory of Stationery and Printing			100.00
Unexpired Insurance			766.66
To transfer book value of assets destroyed by fire to Fire Loss Account.			
(3)			
Salvage		40,000.00	
Insurance Companies		100,000.00	
To--Fire Loss			140,000.00
Insurance Companies	$100,000.00		
Salvage from property assets	30,000.00		
Salvage from inventories	10,000.00		
	$140,000.00		
(4)			
Surplus		180,177.19	
To--Fire Loss			180,177.19
To transfer net loss to Surplus.			
(5)			
Bond Interest		1,225.00	
To--Bond Interest Accrued			1,225.00
Interest accrued since July 1.			

(6)			
Surplus		$ 1,225.00	
To--Bond Interest			$ 1,225.00
To close latter account.			
(7)			
Realization and Liquidation Account		670,431.32	
To--Land			40,000.00
Good-Will			66,000.00
Customers' Accounts			104,013.40
Notes Receivable			116,003.00
Accrued Interest on Notes Receivable			315.92
Discount on Stock			2,000.00
Advances			2,000.00
Rent Paid in Advance			100.00
Investment			200,000.00
Salvage			40,000.00
Insurance Companies			100,000.00
To transfer assets to Realization and Liquidation Account.			
(8)			
5% First Mortgage Bonds		150,000.00	
6% First Mortgage Bonds		75,000.00	
Audited Vouchers		60,144.12	
Bond Interest Accrued		5,850.00	
Taxes Accrued		2,295.34	
Pay-Roll Accrued		41,649.55	
To--Realization and Liquidation Account			334,939.01
To transfer liabilities to be liquidated to Realization and Liquidation Account.			
(9)			
Reserve for Bad Debts		1,522.75	
Reserve for Discounts		1,800.00	
To--Realization and Liquidation account			3,322.75
To transfer reserve for bad debts and discounts to Realization and Liquidation Account.			
(10)			
Cash		385,833.47	
To--Realization and Liquidation Account			385,833.47
Assets realized as follows:			
Notes Receivable and accrued Interest	$ 52,253.25		
Accounts Receivable	49,480.22		
Land	44,100.00		
Investment	100,000.00		
Salvage	40,000.00		
Insurance Companies	100,000.00		

(11)

Realization and Liquidation Account		$334,939.01	
To--Cash			$334,939.01
Liabilities paid as follows:			
5% First Mortgage Bonds	$150,000.00		
6% First Mortgage Bonds	75,000.00		
Audited Vouchers	60,144.12		
Bond Interest Accrued	5,850.00		
Taxes Accrued	2,295.34		
Pay-roll Accrued	41,649.55		

(12)

Realization and Liquidation Account	9,842.78	
To--Cash		9,842.78
Expenses of liquidation.		

(13)

Surplus	291,118.88	
To--Realization and Liquidation		291,118.88
Loss on liquidation.		

(14)

7% Preferred Stock	91,738.13	
To--Cash		91,738.13
Final dividends of 91.73 to 7% preferred stock.		

(15)

Common Stock	66,100.00	
To--Unissued Stock		66,100.00
To close latter account.		

(16)

Common Stock	433,900.00	
7% Preferred Stock	8,261.87	
To--Surplus		442,161.87
To close accounts on surrender of stock certificates for cancellation.		

CASH ACCOUNT

Balance	$ 50,686.45	Wages and Taxes	$ 43,944.89
Insurance	100,000.00	Bonds and Accrued Interest	230,850.00
Notes Receivable and Accrued Interest	52,253.25	Audited Vouchers	60,144.12
Accounts Receivable	49,480.22	Expenses	9,842.78
Land	44,100.00	Dividend 7%, Preferred Stockholders	91,738.13
Salvage	40,000.00		
Investment	100,000.00		
	$436,519.92		$436,519.92

Solution to Problem 13

THE MILLER MOTOR CAR COMPANY
Central Trust Company, Receiver
STATEMENT OF REALIZATION AND LIQUIDATION
AUGUST 6, 1918

ASSETS TO BE REALIZED:			
Customers' Accounts		$104,013.40	
Notes Receivable		116,003.00	
Accrued Interest on Notes Receivable		315.92	
		$220,332.32	
Less Reserves for:			
Bad Debts	$1,522.75		
Discounts	1,800.00	3,322.75	
		$217,009.57	
Land		40,000.00	
Good-Will		66,000.00	
Discount on Stock		2,000.00	
Advances		2,000.00	
Rent Paid in Advance		100.00	
Investment		200,000.00	
Salvage		40,000.00	
Insurance Company		100,000.00	$667,109.57
LIABILITIES LIQUIDATED:			
5% First Mortgage Bonds		$150,000.00	
6% First Mortgage Bonds		75,000.00	
Audited Vouchers		60,144.12	
Bond Interest Accrued		5,850.00	
Taxes Accrued		2,295.34	
Pay-Roll Accrued		41,649.55	334,939.01
EXPENSES			9,842.78
			$1,011,891.36

LIABILITIES TO BE LIQUIDATED:		
5% First Mortgage Bonds	$150,000.00	
6% First Mortgage Bonds	75,000.00	
Audited Vouchers	60,144.12	
Bond Interest Accrued	4,625.00	
Taxes Accrued	2,295.34	
Pay-Roll Accrued	41,649.55	$333,714.01
ADDITIONAL LIABILITIES ACCRUED:		
Bond Interest Accrued		1,225.00
ASSETS REALIZED:		
Notes Receivable and Accrued Interest	$ 52,253.25	
Accounts Receivable	49,480.22	
Land	44,100.00	
Investment	100,000.00	
Salvage	40,000.00	
Insurance Company	100,000.00	385,833.47
Loss on Realization and Liquidation		291,118.88
		$1,011,891.36

ANSWERS TO QUESTIONS

Answer to Question 21--

(a) OPENING ENTRIES are those entries required to be made at the inception of an enterprise and usually to record the amount and nature of the capital investment, e.g., single proprietor's or partner's capital contribution, or capital stock in the case of a corporation, and on the other hand the property and other assets acquired to enable the enterprise to commence operations.

(b) CLOSING ENTRIES are those entries required to be made at the close of a given period to transfer the balances in the various nominal or profit and loss accounts to the manufacturing, trading, or profit and loss accounts as the case may be. After the closing entries have been made the balances in the various accounts represent the capital and current assets, deferred charges, capital and current liabilities, including the balance of the Surplus Account in the case of a corporation.

The term is also applied to the entries required to close the books of a single-proprietorship, co-partnership, or corporation on the liquidation of the business by sale or otherwise.

(c) ADJUSTING ENTRIES are entries that must be made in order that the accounts prepared at any given date may be correctly stated and usually are rendered necessary because of the failure to take up all of the income and expenditure relating to a given period and therefore are really an adjustment of the results between periods; for instance, taking up accrued interest, setting up inventory reserve, etc.

Answer to Question 22--

(a) ACCRUED INTEREST on BILLS RECEIVABLE represents the interest earned on bills receivable but not due at a given date. The interest may be "inventoried" or handled on the "accrual" basis.

1. Open an account entitled:

ACCRUED INTEREST ON BILLS RECEIVABLE

DEBIT WITH	CREDIT WITH
Total amount of interest on bills receivable accruing during the current month--contra a credit to Interest Earned, Profit and Loss Account.	Interest received on bills receivable--contra a debit to Cash Account.

The balance of the account represents the accrued interest on bills receivable, and is shown as a current asset on the balance sheet.

2. Open an account entitled:

INTEREST RECEIVED

DEBIT WITH	CREDIT WITH
Accrued interest on bills receivable at beginning of period--contra a credit to Accrued Interest on Bills Receivable (asset account).	Interest Received on bills receivable during period--contra a debit to Cash Account. Accrued Interest on bills receivable at the end of period--contra a debit to Accrued Interest on Bills Receivable (asset account).

The balance of the account represents the net interest earned during the period and is transferred to the credit of the Profit and Loss Account.

ACCRUED INTEREST on BILLS PAYABLE represents interest accrued but not due at a given date. If the interest is matured but unpaid, it should be styled "Matured Interest on Bills Payable Unpaid." Accrued interest may be handled in one of two ways:

1. Open an account entitled:

ACCRUED INTEREST ON BILLS PAYABLE
(Liability account)

DEBIT WITH	CREDIT WITH
Total payments of interest on bills payable during period--contra a credit to Cash.	Total amount of interest on bills payable accruing during current month --contra a charge to Interest Paid (profit and loss account).

The balance of the account represents unpaid accrued interest on bills payable and would be shown as a current liability on the balance sheet.

2. Or pass the accrued interest through the Interest Paid Account as follows:

INTEREST PAID
(Profit and loss account)

DEBIT WITH	CREDIT WITH
Interest paid during period. Interest accrued but unpaid at end of period--contra a credit to Accrued Interest on Bills Payable Account.	Interest accrued but unpaid at beginning of period--contra a debit to Accrued Interest on Bills Payable Account.

The balance of the account represents the net interest charge for the current period and is transferred to the debit of the Profit and Loss Account.

(b) INSURANCE UNEXPIRED represents the unearned insurance premiums or the insurance unexpired at any given date, being an expenditure incurred in one period which applies to that and subsequent periods and properly should be carried forward in order that the expense of carrying insurance may be equitably distributed over the term of the policy. The transactions that would enter into the Insurance Unexpired Account are shown below:

(1)

INSURANCE UNEXPIRED ACCOUNT

DEBIT WITH

- Insurance unexpired, or unearned insurance premiums at the beginning of the period.
- Insurance premiums paid or credited during the period--contra a credit to Cash or Accounts Payable.

CREDIT WITH

- Cost of carrying insurance during the period or the earned insurance premiums--contra a debit to Insurance Premium Account (profit and loss account).
- Return premiums on policies cancelled during the period.

The balance of the account, insurance unexpired, or unearned insurance premiums at the end of the period, would appear in the balance sheet as a deferred charge to operations.

In some companies the insurance premiums are handled in the manner illustrated above, although in the smaller enterprises the following method of dealing with the insurance premiums is generally adopted:

(2)

INSURANCE PREMIUMS ACCOUNT

(A profit and loss account, except at the end of the period, when the insurance unexpired, or unearned insurance premium, is recorded in the account, when it becomes a deferred charge to operations account)

DEBIT WITH

- Insurance unexpired, or unearned insurance premiums, at the beginning of the period, being the amount brought down from the previous period.
- Insurance premiums paid or credited during the period--contra a credit to Cash or Accounts Payable.

CREDIT WITH

- Insurance unexpired, or unearned insurance premiums, at the end of the period.
- Return premiums on policies cancelled during the period.

The balance of the account, cost of carrying insurance during the period, transferred to the debit of the Manufacturing, Trading, or Profit and Loss Accounts, as the case may be.

(c) RENTS PAID IN ADVANCE represents the unearned rent or prepaid rent at any given date; also an expenditure incurred in one period, the benefit from which accrues to a succeeding period. An illustration of the transactions entering into such an account is given below:

RENTS PAID IN ADVANCE ACCOUNT

(A deferred charge to operations account)

DEBIT WITH

- Rents paid in advance at the beginning of the period.
- Rents paid during the period--contra a credit to Cash or Accounts Payable.

CREDIT WITH

- Rents paid in advance at the end of the period.

The balance of the account, rental charge for the period, transferred to the debit of the Manufacturing, Trading, or Profit and Loss Accounts, as the case may be.

Rents paid in advance can also be handled much the same as Insurance Unexpired Account referred to in (1).

Answer to Question 23--The effect on the balance sheet of increasing the reserve for depreciation in the case of a manufacturing business will be somewhat as follows:

1. The book value of the capital assets will be decreased.
2. Profit and loss, and hence surplus, will be decreased to the extent that depreciation charges have been included in cost of sales.
3. Work in process and finished stock inventory will be increased, owing to the fact that the large increase in the provision for depreciation will make necessary a raise in the burden rate, thus affecting all goods worked on during the period whether sold or still on hand.
4. Working capital will be increased by that proportion of the additional depreciation apportionable to inventories on hand December 31, 1918.

Answer to Question 24--

(a) Unless the company owns a controlling interest it is improper to take up any earnings of the other company until a dividend is declared. The policies of the other company are dictated by others and losses may subsequently occur which will prevent the payment of a dividend. The entry made anticipates an unrealized profit.

(b) A resolution of the board of directors must authorize this entry. The general manager does not have the authority. Writing up the value of property assets is contrary to good accounting practice except when financing is undertaken or a sale is to be made, etc. The credit should be to capital surplus rather than surplus, since the profit is as yet unrealized.

(c) If the current provision was excessive by this amount, the entry is correct. In this case future provisions should be made on the new basis. To write back the depreciation merely for the purpose of increasing book profits is incorrect.

Answer to Question 25--The following draft form will probably meet the conditions set out in the question:

CASH RECEIPTS

DATE	ACCOUNT	PARTICULARS	FOLIO	SALES LEDGERS NO. 1	SALES LEDGERS NO. 2	DISCOUNT ON SALES	PRIVATE LEDGER	BANK

CASH DISBURSEMENTS

DATE	ACCOUNT	PARTICULARS	CHECK NUMBER	FOLIO	AUDITED VOUCHERS	PRIVATE LEDGER	BANK

The essential features are separate columns for Sales Ledger No. 1, Sales Ledger No. 2, and Audited Vouchers, so that the monthly totals may be obtained for posting purposes.

RECEIVERSHIPS

In Lectures 1 and 3, the statement of affairs and the realization and liquidation account have been explained as being those prepared immediately preceding and immediately following the dissolution of a business. Or, a statement of affairs may be utilized to portray the condition of a business on a forced sale basis, whether actual liquidation is contemplated or not. It remains now to consider another aspect of a corporation's records, i.e., the accounts kept during the administration of a receiver.

It sometimes happens that a debtor will assign all or part of his assets to a creditor, or other assignee, for the purpose of satisfying certain of his creditors. The assignee is a receiver in equity if formal application is made through a court. Insolvency need not exist, but the act of assignment is one of bankruptcy.

However, if all the creditors are agreed, the receiver in equity may continue his administration of the business for an indefinite period until (a) the creditors are satisfied, (b) bankruptcy proceedings are initiated, or (c) reorganization takes place. In connection with the accounts kept by a receiver, the following points should be noted:

1. The receiver should open a separate set of books containing:

   (a) All the assets of the business, the valuation reserve accounts, and all other items except investment and liability accounts (accrued up to the date of his appointment) which have been assigned to him.

   (b) Capital asset accounts may be omitted but are usually transferred.

It is desirable but not essential that the schedule of accounts used by the receiver should be the same as that of the business taken over, in order that analyses of operations under his administration may be compared with operations before his appointment.

2. Accrued assets should be computed as of the day of the receivership and the books brought up to date before transfer is made charging the receiver with the assets taken over. The closing entries of the business with regard to the receiver's account should agree with the opening entries on the receiver's books. The corporation will charge "A B, Receiver" while the receiver will credit "C Company, in receivership." These two accounts may be reconciled in much the same manner as home office and branch office accounts.

3. The receiver's operations will be strictly separated from previous transactions. Liabilities of the previous administration which he pays will be charged to an account properly designated or directly to the corporation's account. Preference in such payment will be made as described under the statement of realization and liquidation.

4. As a rule, all current items of expense will be charged to expense accounts in the usual way, without similar entries being made on the books of the corporation. However, certain items, such as bond interest, are obligations not incurred by the receiver and will be accrued on the corporation's books. When the interest is paid, accrued interest will be charged and the receiver's account credited. On the receiver's books, cash will be credited and the corporation's account or "Interest, A B Co." charged.

5. The receiver's books should be closed at the end of each fiscal or calendar year in conformity with the previous practice of the corporation.

6. Reports which receivers submit are usually prescribed in a general way, at least, by the court, but the accountant may, in addition, add to the report and exhibits such other information which in his opinion are essential to a proper interpretation of the receiver's transactions. The exhibits will include:

(a) Balance sheet, generally combined with the balance sheet of the corporation to show the financial condition of the corporation in receivership.
(b) Statement of profit and loss during the receiver's administration, together with combined statement of receiver's profit and loss and corporation's profit and loss (if any) during the fiscal period under review.
(c) Detailed schedules supporting (a) and (b) where necessary.
(d) Statement of application of funds during the period of receiver's administration. (For the construction of this statement see Lecture 12.)
(e) A statement of charge and discharge similar to the statement prepared in connection with estate accounts (Lecture 10) instead of (d).
(f) Occasionally, a summary of cash receipts and disbursements.

7. The receiver terminates his accounts according to the method of disposing of the business which may be one of the following:

(a) Initiation of bankruptcy proceedings. The receiver will turn over his assets to the receiver in bankruptcy just as the corporation turned over its assets to the receiver in equity. The distinction between these two sorts of receiverships should be noted.
(b) Reorganization.
(c) Sale.

8. When the receivership ends, the profits of the receivership should be entered on the corporation's books preliminary to closing the latter, and likewise all assets and liabilities turned back by the receiver should be entered and his account closed.

REFERENCES:

H. C. Freeman, Yearbook American Institute of Accountants, 1917, pages 83-104
Bays, Debtor and Creditor and Bankruptcy.

COMPLETE ACCOUNTING COURSE--PART II

Lecture 8

BRANCH HOUSE ACCOUNTING

Problem 18

The American Manufacturing Co. opened a branch store on July 1, 1918, in one of the large cities with A as manager. From that date to June 30, 1919, the following transactions took place:

1. Merchandise to the value of $11,083.77 was shipped during the year direct from the warehouse of the home office.
2. Freight charges (prepaid by the home office) thereon amounted to $911.03.
3. Uncollected customers' accounts at June 30, 1919, amounted to $3,911.33, and the Accounts Payable (in respect of salaries and other expenses) to $598.11.
4. Materials to the value of $8,378.11 were purchased by and paid for direct by the branch.
5. The total sales of all products during the year ended June 30, 1919, amounted to $30,811.74.
6. Branch expenses paid (including salaries of salesmen and office clerks, rent, light, advertising, etc., but exclusive of the unpaid items above referred to) $6,987.45.
7. Charge of $675 rendered by the home office in respect of the proportion of management salaries and expenses chargeable to the branch office.
8. Materials to the value of $1,318.11 were shipped to Branch II of the company (including the freight charges thereon of $98.11).
9. Inventory of materials on hand June 30, 1919, $1,103.27.

A separate set of books was kept at the branch and you are required to prepare:

(a) The necessary entries to record the foregoing transactions on both the branch and home office books.
(b) The necessary closing journal entries for the branch books.
(c) The necessary entries to take up the profit or loss on the home office books.
(d) The necessary statements to show the profits or losses from trading, and a summary of the transactions between the branch and the home office.

Problem 19

The General Manufacturing Co. asks you to prépare its general balance sheet at December 31, 1918. Its home office is located in New York. It has a plant in Chicago and branches in San Francisco, New Orleans, and Omaha, each having a separate set of books. Following are the trial balances at December 31, 1918, after closing.

HOME OFFICE
TRIAL BALANCE, DECEMBER 31, 1918

Cash	$ 58,000.00	
Accounts Receivable	294,300.00	
Inventories	773,200.00	
Other Current Assets	43,650.00	
Interest Insurance and Taxes Prepaid	12,590.00	
Bond Discount not Amortized	2,500.00	
Stocks of Other Companies	120,000.00	
Miscellaneous Stocks and Bonds	12,250.00	
Liberty Bonds	125,000.00	
Sinking Fund Investment	10,000.00	
Land	78,410.00	
Buildings	183,540.00	
Machinery and Equipment	65,450.00	
Office Furniture and Fixtures	7,320.00	
Delivery Equipment	5,425.00	
Construction in Progress	30,158.00	
Other Fixed Assets	16,380.00	
Good-will	350,000.00	
Current Account--Plant	356,750.00	
Current Accounts--Branches	135,800.00	
Depreciation Reserve		$ 97,700.00
Notes Payable		695,000.00
Accounts Payable		52,800.00
Accrued Interest, Taxes, and Wages		5,380.00
Other Current Liabilities		3,250.00
Bonds Issued and Outstanding		500,000.00
Capital Stock		1,000,000.00
Contingent Reserves		75,000.00
Surplus		210,500.00
Profit and Loss		66,093.00
Dividends Paid	25,000.00	
	$2,705,723.00	$2,705,723.00

CHICAGO PLANT
TRIAL BALANCE, DECEMBER 31, 1918

Cash	$ 38,760.00	
Petty Cash	950.00	
Trade Accounts Receivable	99,255.00	
Sundry Accounts Receivable	23,490.00	
Inventory Merchandise	185,650.00	
Inventory Supplies	4,375.00	
Sundry Current Assets	3,290.00	
Interest Prepaid	3,600.00	
Insurance Prepaid	2,144.00	
Miscellaneous Prepaid Charges	630.00	
Liberty Bonds	25,000.00	
Buildings	38,400.00	
Machinery and Equipment	15,460.00	
Office Furniture and Fixtures	1,190.00	
Delivery Equipment	11,050.00	
Depreciation Reserve		$ 18,480.00
Notes Payable		180,000.00
Trade Accounts Payable		13,819.00
Sundry Accounts Payable		10,080.00
Accrued Interest		1,160.00
Accrued Wages		850.00
Other Current Liabilities		1,300.00
Home Office Account		227,555.00
	$453,244.00	$453,244.00

BRANCH HOUSES
TRIAL BALANCES, DECEMBER 31, 1918

	NEW ORLEANS	SAN FRANCISCO	OMAHA
Cash	$ 575.00	$ 2,191.00	$ 1,914.00
Petty Cash	50.00	75.00	100.00
Trade Accounts Receivable	10,360.00	17,468.00	15,686.00
Sundry Accounts Receivable	130.00	187.00	632.00
Inventory Merchandise	11,095.00	18,380.00	10,144.00
Inventory Supplies	140.00	225.00	328.00
Insurance and Miscellaneous Prepayments	175.00	195.00	310.00
Land	2,230.00	4,157.00	------
Buildings	10,025.00	16,320.00	------
Machinery and Equipment	2,330.00	3,230.00	6,320.00
Office Furniture and Equipment	765.00	316.00	375.00
Delivery Equipment	950.00	831.00	860.00
	$38,825.00	$63,575.00	$36,669.00

Trade Accounts Payable	$ 2,960.00	$ 5,954.00	$ 2,914.00
Miscellaneous Accounts Payable	336.00	1,953.00	375.00
Accrued Taxes	143.00	783.00	------
Accrued Wages	260.00	460.00	176.00
Depreciation Reserve	1,460.00	2,130.00	2,850.00
Home Office Account	33,666.00	52,295.00	30,354.00
	$38,825.00	$63,575.00	$36,669.00

Upon reconcilement of the plant and branch current accounts the following items were found to be open:

1. Account with plant at Chicago:

    (a) Charge by home office of $100,000 cash sent to plant; not taken up by plant
    (b) Invoices for goods shipped to plant, for which plant has not given credit, aggregating $29,195

2. Branch house current accounts:

    (a) Charges by branches against customers whose accounts are carried at the home office--no credit yet given by home office--$8,400
    (b) Invoices for goods shipped and charged to branches--not credited by branches--aggregating $11,085

You are requested to prepare a balance sheet of the General Manufacturing Co. at December 31, 1918, having due regard for the elimination of inter-office accounts.

Prepare in connection with the above a working sheet showing how the final balance sheet totals were arrived at.

MISCELLANEOUS QUESTIONS

Question 36--A company operating a number of departments desires to know the profit on sales by each department. How would you suggest that the books be kept in order that the desired information can be furnished to the management?

Question 37--How should the following expenditures be distributed in the accounts of a manufacturing concern: Payments aggregating $11,037.27 for real estate, personal property, and corporation taxes for the year 1918--monthly provisions have been made for the accrued taxes.

Question 38--What is the difference between cash dividends, bonuses to officers, and stock dividends? Formulate the entries required to be made in dealing with each item.

Question 39--How should preferred stock dividends in arrears be stated in the balance sheet of a company?

Question 40--How would you state the following items in a balance sheet?

(a) Unpaid subscriptions to capital stock.
(b) Unissued capital stock.
(c) Dividends declared and unpaid.

Solution to Problem 14

Exhibit I

F AND G
BALANCE SHEET, JUNE 30, 1919

ASSETS

CAPITAL ASSETS:		
Real Estate & Bldgs.	$30,083.27	
Machy. & other Equip.	19,093.09	
Tool Equip.	1,903.23	
Total Capital Assets		$ 51,079.59
CURRENT ASSETS:		
Inventories of Finished Product	$ 1,835.07	
Raw Material	1,108.37	
Customers' Accounts	51,027.03	
Notes Receivable	4,705.27	
Accrued Interest on Notes Receivable	135.34	
Cash	12,403.24	
Total Current Assets		71,214.32
Total All Assets		$122,293.91

LIABILITIES

	F	G
CAPITAL ACCOUNTS:		
Balance at July 1, 1918	$23,983.27	$ 17,093.27
Profits for year	27,633.86	27,633.85
Interest on Capital	1,800.06	1,374.46
	$53,417.19	$46,101.58
LESS--drawings	1,800.00	1,700.00
Balance at June 30, 1919	$51,617.19	$44,401.58
Total of Capital Accounts		$96,018.77
CURRENT LIABILITIES:		
Bills Payable	$ 9,000.00	
Accounts Payable	17,091.07	
Accrued Interest on Bills Payable	184.07	
Total Current Liabilities		26,275.14
Total Capital & Liabilities		$122,293.91

Exhibit II

F AND G
COMPARATIVE STATEMENT OF PROFIT AND LOSS
SIX MONTHS ENDING DECEMBER 31, 1918, AND JUNE 30, 1919

PARTICULARS	SIX MONTHS ENDING DECEMBER 31, 1918		SIX MONTHS ENDING JUNE 30, 1919		INCREASE OR DECREASE*	
	Amount	% to Sales	Amount	% to Sales	Amount	% to Sales
Sales	$59,276.05	100.00	$61,323.70	100.00	$2,047.65	----
Cost of Sales (Exhibit II-A)	28,648.95	48.33	24,326.51	39.67	*4,322.44	*8.66
Gross Profit from Operation	$30,627.10	51.67	$36,997.19	60.33	$6,370.09	8.66
Less--						
Selling Expenses	$ 3,981.93	6.72	$ 3,136.99	5.12	*$ 844.94	*1.60
General and Adm. Expenses	1,688.85	2.85	1,022.82	1.67	*666.03	*1.18
	$ 5,670.78	9.57	$ 4,159.81	6.79	*$1,510.97	*2.78
	$24,956.32	42.10	$32,837.38	53.54	$7,881.06	11.44
Add--Miscellaneous Income (net)	1,788.93	3.02	*381.85	*0.62	*2,170.78	*3.64
	$26,745.25	45.12	$32,455.53	52.92	$5,710.28	7.80
Less--Interest (net)	1,081.36	1.82	*322.81	*0.53	*1,404.17	*2.35
	$25,663.89	43.30	$32,778.34	53.45	$7,114.45	10.15
Less--Interest on Partners' Accounts	1,232.30	2.08	1,942.22	3.17	709.92	1.09
Surplus Net Profits	$24,431.59	41.22	$30,836.12	50.28	$6,404.53	9.06
Distributed as follows:					Total	
F	$12,215.80		$15,418.06		$27,633.86	
G	12,215.79		15,418.06		27,633.85	
Total, as above	$24,431.59		$30,836.12		$55,267.71	

*Red.

If it is assumed that the selling price is unchanged during the year, the analysis of profits will appear as follows:

Increase in Gross Profits due to Increase in Sales ($2,047.65 x 51.67%)		$1,057.99
Increase in Gross Profits due to proportionate decrease in Cost of Sales ($61,323.70 x 8.66%)		5,312.10
Total Increase in Gross Profits		$6,370.09
Add--Decrease in		
Selling Expenses	$ 844.94	
General and Administrative Expenses	666.03	1,510.97
		$7,881.06
Deduct--Decrease in Miscellaneous Income	$2,170.78	
Increase in Interest (net)	1,404.17	766.61
		$7,114.45
Deduct--Increase in Interest Allowance on Partners' Capital Accounts		709.92
Net Increase in Surplus Net Profits		$6,404.53

F AND G

STATEMENT OF COST OF PRODUCTION AND GOODS SOLD

	SIX MONTHS ENDED DECEMBER 31,1918		SIX MONTHS ENDED JUNE 30, 1919	
RAW MATERIALS USED:				
Inventory of Raw Material at beginning of the period	$ 9,027.03		$ 989.11	
Raw Materials purchased	9,183.91		12,382.09	
	$18,210.94		$13,371.20	
Less--Inventory of Raw Material at end of period	989.11	$17,221.83	1,108.37	$12,262.83
PRODUCTIVE LABOR		9,988.91		8,957.34
FACTORY EXPENSES:				
Heat and Power	$ 1,403.27		$ 1,501.56	
Taxes	341.55		446.89	
Insurance	451.05		330.98	
Factory Expenses	818.17	3,014.04	1,086.15	3,365.58
Cost of Goods Manufactured		$30,224.78		$24,585.75
INVENTORY VARIATIONS:				
Inventory of Finished Product at beginning of the period	$---------		$ 1,575.83	
Inventory of Finished Product at end of period	1,575.83	1,575.83	1,835.07	259.24
Cost of Goods Sold (Exhibit II)		$28,648.95		$24,326.51

Exhibit III

SUMMARY OF PARTNERS' CAPITAL ACCOUNTS

	F	G	TOGETHER
Balance as at July 1, 1918	$23,983.27	$17,093.27	$41,076.54
ADD--Profits for the six months ending December 31, 1918	12,215.80	12,215.79	24,431.59
Interest on Capital Accounts for the six months ending December 31, 1918	719.50	512.80	1,232.30
	$36,918.57	$29,821.86	$66,740.43
DEDUCT--Cash withdrawals during the six months ending December 31, 1909	900.00	1,100.00	2,000.00
Balance as at December 31, 1918	$36,018.57	$28,721.86	$64,740.43
ADD--Interest on Capital Accounts for the six months ending June 30, 1919	1,080.56	861.66	1,942.22
Profits for the six months ending June 30, 1919	15,418.06	15,418.06	30,836.12
	$52,517.19	$45,001.58	$97,518.77
DEDUCT--Cash withdrawals during the six months ending June 30, 1919	900.00	600.00	1,500.00
BALANCE--Capital Accounts June 30, 1919, as per balance sheet as of that date	$51,617.19	$44,401.58	$96,018.77

ANSWERS TO QUESTIONS

Answer to Question 26--

(a) Fixed charges are those expenditures that are of a more or less fixed nature in connection with the conduct of a business and include such items as interest on bonded indebtedness, provision for sinking fund, etc. The term is used particularly among public utility corporations, although its use has extended to other companies.

(b) Replacement expenditures are those expenditures incurred in the renewal or replacement of plant, machinery, tools, and other equipment which are worn out or obsolete. Expenditures of this nature must be met out of profits or earnings.

(c) Maintenance expenditures are expenditures incurred in connection with the repair, maintenance, or upkeep of a property in order to maintain the necessary efficiency to permit of the successful operation of the property. This class of expenditure is chargeable against the period in which the same was incurred, and under no circumstances can ordinary repairs be carried forward as a deferred charge against a subsequent period. In some businesses,

particularly a business of "seasons," it is necessary to make some provision during the producing period for repairs that necessarily have to be deferred until the "slack" or intervening period. This is generally accomplished by debiting Operating Expenses and crediting "Provision for Accrued Repairs." This amount may be based on a certain sum "per ton" of product produced, or on past experience.

Answer to Question 27--Capital assets are those more or less permanent in nature, by means of which the business is carried on, and which are held for the purpose of earning income, and not for the purpose of sale, e.g., land, buildings, plant, machinery, etc

If asked to explain why the capital assets appear in the balance sheet in amounts in excess of what they would realize if sold, the auditor should say that it is not necessary to take into account the market value of capital assets which may be subject to considerable fluctuations. The question to consider is their value to the business as a going concern, and not the break-up value. In the event of a forced realization, heavy losses would probably ensue, but it would not be reasonable to anticipate such losses before arriving at the current profits of the business.

Answer to Question 28--

(a) Additions and extensions to property, $98,102.15. From the description of the expenditure it is quite obvious that the amount is a proper charge to Capital Account.

(b) Extraordinary repairs and renewals, $18,027.11. These charges should be made against the Depreciation Reserve, being expenditures incurred in making good depreciation and prolonging the life of the equipment repaired and renewed.

(c) Ordinary repairs and renewals, $27,081.33. These expenditures must be charged to the current operating expenses of the period in which they were incurred and under no circumstances can they be carried forward as "Deferred Charges."

(d) The replacement value of $125,091.27 is proper charge against Property Account, provided that the same account is relieved by a charge against the Depreciation Reserve of the estimated original cost value ($81,047.27) of the equipment replaced. In this case the salvage of $9,818.28 recovered would be credited to the Depreciation Reserve Account.

Answer to Question 29--

(a)

Scrap	$ 10,000.00	
Depreciation Reserve	91,000.00	
To--Property Account		$101,000.00
To write off value of buildings torn down.		

Property Account $175,000.00
To--Construction Account $175,000.00
To set up value of completed buildings.

(b)

Depreciation Reserve 31,093.87
To--Construction 31,093.87
Value of extraordinary renewals of machine shop equipment.

Answer to Question 30--

(a) The expenditure of $11,383.11 apparently represents extensive repair and renewal work in connection with the soap-making machinery and if this is the case the amount would be a proper charge against the Depreciation Reserve Account. The information given in the question is too meager to definitely state the most conservative treatment to adopt--the facts would have to be ascertained. It may be that the amount should be apportioned between (1) repairs and renewals and (2) depreciation reserve.

(b) The advance of $5,000 to John Smith should be charged to his account and shown on the face of the balance sheet under the general heading of Deferred Charges as "Prepaid Salaries." The amount should be written off against the six months' operations in monthly instalments of $833.33 each.

(c) The improvement expenditure of $25,000 on the machine shop equipment. As previously pointed out, improvement expenditures are frequently regarded as capital charges. It may be that in this case some part of the amount of $25,000 represents capital outlay. Improvement expenditures, from a conservative point of view, are in the nature of deferred operating charges to be written off in a few years' time or over the estimated life of the improvement

BRANCH HOUSE ACCOUNTING

In connection with the development of large scale operations, it frequently becomes desirable for a business to maintain plants or branches in various parts of the country. Inasmuch as the central office may be located at a distance from the branches, it is necessary to devise special methods of control properly to handle their accounts.

CURRENT ACCOUNTS BETWEEN OFFICES--The home office will provide in its general ledger an account for each branch and, conversely, each branch will maintain an account with the home office. In case there are a number of branch accounts, it is desirable to place these accounts in a separate ledger under a control account in the general ledger. Transactions between branches are likely to occur frequently, but it is desirable to handle such transactions through the home office books. The Home Office Account on the books of the branch is charged or credited with all transactions and, similarly, these transactions are listed on the Branch Current Account in the home office books. The frequency of branch house reports, as well as the amount of detail informa-

tion to be included, depends upon the volume of transactions. Daily statements are sometimes used, but more often weekly or monthly statements are provided for.

Branch House Accounts should be reconciled monthly or more frequently with the home office books; i.e., all items making up the difference between the balances on the branch and home office accounts, representing mostly in-transit items, should be listed. The reconciliation is usually prepared by the branch and may be made up in the following manner:

Charges by branch--not credited by home office	$--------
Credits by home office--not taken up by branch house	--------
	$--------
Credits by branch--not charged by home office	$--------
Charges by home office--not credited by branch house	--------
Difference in accounts	$--------

Such differences can then be properly classified for balance sheet purposes; thus, if the open items represent merchandise in transit the inventory account would be debited or credited as the case may be; if cash items are in transit the cash account in the balance sheet must be adjusted, etc.

PREPARATION OF REPORTS FOR LARGE ORGANIZATIONS--Large organizations having many plants and branches, each carrying its own set of books, find it very desirable to have a standard classification of accounts and standard report forms. These are more readily consolidated or accumulated at the end of the period in order to arrive at the general balance sheet and general income account of the company.

The classification of accounts used should be built around the same prime accounts for all the plants or branches though, of course, the subsidiary or secondary accounts may not be the same. A branch, for instance, will usually carry many accounts in its ledger that in the case of a plant would appear in some subsidiary record. The same will hold true of a plant, that it will have many accounts that at the home office might appear under some control account.

The balance sheets submitted by the plants and branches, therefore, should group the individual accounts under prime accounts so that the consolidation to be prepared will consist only of prime accounts, i.e., those which will appear in the final balance sheet or income statement.

It is advantageous to have the plants and branches show their accounts in detail, as it enables the main office to keep a better control over the branch accounts. Such accounts as Prepaid Interest, Insurance, Accrued Wages, Accrued Taxes, etc., can be controlled more readily if carried in detail. Accounts receivable will usually appear divided as between trade and sundry, and the trade accounts classified between current, past due, suspended, etc.

CLOSING OF ACCOUNTS AND PREPARING REPORTS--Branches and plants should close their books at the end of the period in the usual way. Their nominal accounts are all closed out to Profit and Loss and a statement prepared. This, together with a balance sheet, is forwarded to the home office. At the same time the

branch will make an entry transferring the balance in its Profit and Loss Account to its Home Office Account.

The home office then picks up this Profit and Loss of the plant or branch and transfers it from the current account to the general Profit and Loss Account. It closes out its own Income accounts and draws off a trial balance after closing which is its balance sheet.

The general balance sheet is then prepared by combining all plant and branch house balance sheets with the home office and eliminating inter-office accounts. A general Income account would be prepared in a like manner by combining all the individual income statements and eliminating the interoffice transactions. Columns on a working sheet may be headed up thus (arranged horizontally):

1. Home Office Balance Sheet
2. Plant 1
3. Plant 2
4. Branch 1
5. Branch 2
6. Total (Home Office, Plants, and Branches)
7. Interoffice Eliminations--Debits
8. Interoffice Eliminations--Credits
9. Combined Balance Sheet

Similar procedure is applicable to the Income account.

REFERENCES:

Dicksee, Advanced Accounting, pages 23-29
Kester, Vol. 2, Chapter XXX

COMPLETE ACCOUNTING COURSE--PART II

Lecture 9

DISTRIBUTION OF FACTORY BURDEN

Problem 20

Prepare a statement from the following showing the factory departmental expenses and the percentage of burden in each department for the year:

	DEPT. A	DEPT. B	DEPT. C
Wages of Unskilled Workmen	$20,013.11	$ 18,073.27	$14,091.34
Light	1,078.27	1,303.05	1,811.32
Depreciation	3,989.23	4,809.32	8,073.11
Repairs and Renewals	4,098.28	9,081.78	10,108.33
Taxes	1,100.00	1,400.00	1,800.00
Oil and Waste	989.50	1,208.43	1,383.11
Power Expense	2,138.17	3,289.42	3,033.11
Productive Labor	93,107.32	101,391.42	98,103.12

GENERAL FACTORY EXPENSES

Superintendent's Salary	$6,000.00
Foremen's Salaries	8,950.00
Factory Office Salaries	4,780.00
Telegraph and Telephone	308.92
Stationery and Printing	989.32

The general factory expenses to be apportioned over the three factory departments in the same proportion as the productive labor of each bears to the total productive labor.

Problem 21

On January 1, 1918, A, B, and C enter a joint venture in oil lands, agreeing to share profits and losses equally. There are two adjacent properties, called the Royal and Arcadia wells, respectively, the cost of which to the partners follows:

Lease for 27 years	$62,000.00	$33,000.00
Less Mortgage given, (dated Jan. 1, 1918 (6%)	41,000.00	10,000.00
Cash Consideration January 1, 1918	$21,000.00	$23,000.00
Legal Fees re Title March 1, 1918	1,250.00	1,300.00
Land Improvements and Construction Work up to December 31, 1918	12,500.00	10,100.00
Repairs, Labor, and Operating Expenses for 1918	15,250.00	11,600.00
Total cash outlay to December 31, 1918	$50,000.00	$46,000.00

In addition, A, as manager of the properties, is to be credited with a salary of $4,000 for 1918, chargeable to the Royal wells; and B, as his assistant, with $2,000, chargeable to the Arcadia wells. A has assumed the Royal mortgage and B the Arcadia mortgage, while C has financed the remainder of the venture which has consisted of cash receipts from sales amounting to $75,000 for the Royal and $88,000 for the Arcadia and the cash outlay of $96,000 listed above. C is to be credited with interest at 6% on original property payments made, including legal fees, from the date of payment, and on all other expenditures from an average date, which in the case of construction work is fixed at July 1, and operating expenses at August 1, and is to be debited similarly with interest on sales receipts as though all had been received November 1.

It is estimated that in 1918 one twenty-fourth of the expected flow of the Royal wells and one-twentieth of the Arcadia wells had been produced, there being on December 31, 1918, an inventory of oil on hand and unpaid customers' accounts as follows:

	CUSTOMERS' ACCOUNT	OIL ON HAND Market	Cost
Royal	$21,500.00	$ 4,875.00	$1,500.00
Arcadia	32,600.00	32,700.00	4,400.00
Total	$54,100.00	$37,575.00	$5,900.00

The land improvements and construction work are to be regarded as having been in use throughout the year. They will last as long as production continues, at the end of which time they will have an approximate scrap value of $1,000 for each well.

Neglecting income and profits taxes, prepare:

(a) A statement showing the profits and income to which each partner is entitled.

(b) A balance sheet as of December 31, 1918.

On January 1, 1919, the Royal wells are disposed of for $250,000 cash, the purchaser assuming the mortgage and taking over the inventory on hand and the customers' accounts receivable pertaining to the Royal wells. Prepare:

(c) The necessary journal entries to record the transaction.

MISCELLANEOUS QUESTIONS

Question 41--How would you suggest that the following expenditures be distributed:

(a) Expenditures totaling $93,083.11 in respect of real estate, buildings and machinery purchased. The machinery was purchased to replace other machinery of a cost value of $8,131.81. Adequate provision has been made for depreciation.
(b) Officers' salaries, totaling $32,500, in a gas company that has completed and is operating about one-half its plant and is engaged in constructing and equipping the remainder.
(c) Capital stock amounting to $200,000 is issued to pay for a leasehold having 27 years to run.

Question 42--How would you distribute the following expenditures, i.e., between Capital and Revenue Accounts?

(a) Extensive repairs to the power house equipment at a total cost of $4,391.27.
(b) A boiler house was remodeled and extended in order to permit of the installation of larger and more modern type of vertical water tube boilers. The expenditures for remodeling aggregate $4,131.11 and those for the extension $5,103.71.

Question 43--How should the following expenditures be distributed in the accounts of a manufacturing concern:

(a) Repair and renewal of machine shop equipment at a total cost of $11,032.11.
(b) Construction expenditures in connection with the extension of the blacksmith shop, the charges aggregating $27,013.18.

State your reasons for distributing the items in the manner suggested.

Question 44--What is your understanding of the following:

(a) Work in process
(b) Direct or productive labor
(c) Overhead expenses; furthermore, what are two classes of overhead expenses?

Question 45--The value of a certain inventory of finished products on hand at December 31, 1918, is as follows:

Materials	$193,000.75
Productive labor	98,111.32
Factory overhead (basis of 100% of productive labor)	98,111.32
Total	$389,223.39

The actual factory expenses amounted to 120% of the productive labor for the year. Do you consider that the inventory has been properly valued?

Solution to Problem 15

(1)

Realization and Liquidation Account	$40,000.00	
To--Sundry Assets		$40,000.00
To transfer sundry assets to Realization and Liquidation account.		

(2)

Sundry Creditors	14,000.00	
To--Realization and Liquidation Account		14,000.00
To transfer sundry liabilities to Realization and Liquidation account.		

(3)

Cash	14,000.00	
To--Realization and Liquidation Account		14,000.00
First instalment from realization of assets.		

(4)

Realization and Liquidation Account	14,000.00	
To--Cash		14,000.00
Payment of sundry creditors in full.		

(5)

Cash	10,000.00	
To--Realization and Liquidation Account		10,000.00
Second instalment from realization of assets.		

(6)

B--Capital Account	5,000.00	
C-- " "	1,000.00	
To--Cash		6,000.00
To adjust partners' capital investment ratio to profit and loss sharing ratio.		

(7)

A--Capital Account	2,000.00	
B-- " "	1,000.00	
C-- " "	1,000.00	
To--Cash		4,000.00
To distribute balance of cash on hand on basis of adjusted capital accounts--one-half to A, one-quarter to B, and one-quarter to C; the capital ratio now being the same as the profit and loss sharing ratio.		

(8)

Cash	10,000.00	
To--Realization and Liquidation Account		10,000.00
Final instalment from realization of assets.		

(9)

A--Capital Account	$3,000.00	
B-- " "	1,500.00	
C-- " "	1,500.00	
To--Cash		$6,000.00

To charge each partner with his proportion of loss on realization of assets.

(10)

A--Capital Account	5,000.00	
B-- " "	2,500.00	
C-- " "	2,500.00	
To--Cash		10,000.00

To distribute balance of cash on hand and close capital accounts.

SUMMARY OF PARTNERS' CAPITAL ACCOUNTS

PARTICULARS	A	B	C	TOGETHER
Original Investment	$10,000	$10,000	$6,000	$26,000
Cash Dividend to Equalize Capital Accounts	------	5,000	1,000	6,000
Adjusted Capital Accounts	$10,000	$ 5,000	$5,000	$20,000
Cash Dividend	2,000	1,000	1,000	4,000
Adjusted Capital Accounts	$ 8,000	$ 4,000	$4,000	$16,000
Loss on Realization	3,000	1,500	1,500	6,000
Cash--Final Dividend	$ 5,000	$ 2,500	$2,500	$10,000

A B & C
REALIZATION AND LIQUIDATION ACCOUNT
(DATE)

ASSETS TO BE REALIZED:		LIABILITIES TO BE LIQUIDATED:		
Sundry Assets	$40,000.00	Sundry Creditors		$14,000.00
LIABILITIES LIQUIDATED:		ASSETS REALIZED:		
Sundry Creditors	14,000.00	Sundry Assets		34,000.00
		LOSS ON REALIZATION AND LIQUIDATION DIVIDED AS FOLLOWS:		
		A	$3,000.00	
		B	1,500.00	
		C	1,500.00	6,000.00
	$54,000.00			$54,000.00

Solution to Problem 16

Exhibit A

HENRY PARKER, RECEIVER FOR
ASHTON MANUFACTURING COMPANY
BALANCE SHEET, DECEMBER 31, 1918

ASSETS

CURRENT ASSETS:		
Cash	$ 5,650.00	
Accounts Receivable	12,140.00	
Inventory of Raw Material	38,400.00	
Inventory of Finished and Partly Finished Goods	26,120.00	$ 82,310.00
UNAMORTIZED DISCOUNT ON RECEIVER'S CERTIFICATES		3,000.00
CAPITAL ASSETS:		
Real Estate	$ 75,000.00	
Machinery and Equipment	80,000.00	
	$155,000.00	
Less--Reserve for Depreciation	29,500.00	125,500.00
		$210,810.00

LIABILITIES

CURRENT LIABILITIES:		
Accounts Payable	$31,240.00	
Interest Accrued	2,700.00	$ 33,940.00
FIRST MORTGAGE BONDS:		
Par Value	$50,000.00	
Reserve for Premium	5,000.00	55,000.00
RECEIVER'S CERTIFICATES:		
Two-year notes dated July 1, 1918		40,000.00
NET WORTH:		
Capital Stock		80,000.00
Surplus:		
Balance (debit) January 1, 1918	$6,900.00	
Surplus Net Profits for year (Exhibit B)	8,770.00	1,870.00
		$210,810.00

Exhibit B

HENRY PARKER, RECEIVER FOR
ASHTON MANUFACTURING COMPANY
STATEMENT OF PROFIT AND LOSS
YEAR ENDING DECEMBER 31, 1918

SALES		$358,000.00
Less--Cost of Sales:		
Materials used	$ 88,800.00	
Factory Expenses (including Labor and Depreciation)	207,450.00	296,250.00
GROSS PROFIT FROM RECEIVER'S OPERATIONS		$ 61,750.00
DEDUCT--General and Selling Expenses	$ 41,100.00	
Receiver's Expenses	6,680.00	47,780.00
NET PROFIT EXCLUSIVE OF INTEREST		$ 13,970.00
DEDUCT--Interest:		
Bond Interest	$ 3,000.00	
Interest on Receiver's Certificates (including proportion of discount)	2,200.00	5,200.00
SURPLUS NET PROFIT FOR YEAR (Exhibit A)		$ 8,770.00

NOTE--The receiver may desire to qualify the above statements with respect to the items for which he disclaims all responsibility, such as interest; or he may set up in parallel vertical columns the accounts appearing in each set of books in addition to the consolidation above shown.

Solution to Problem 17

(1)

Cash	$105,000.00	
To--A--Capital Account		$ 52,500.00
B-- " "		52,500.00

To record the capital contributed by A and B.

(2)

Real Estate Account	250,000.00	
To--Real Estate Purchase Account		250,000.00

To record the purchase price of property acquired from..........

(3)

Real Estate Purchase Account	100,000.00	
To--Cash		100,000.00

Cash payment in connection with the purchase of the property referred to in the preceding entry.
entry.

(4)

Real Estate Purchase Account	$150,000.00	
To--Mortgage Obligation Outstanding		$150,000.00
To record the mortgage obligation assumed in connection with the purchase of property from..........		

(5)

Real Estate Account	3,000.00	
To--Cash		3,000.00
Expenses paid in connection with the property purchased from..........		

(6)

Uncollected Rentals	----------	
To--Income from Rents		----------

(7)

Cash	----------	
To--Uncollected Rentals		----------

(8)

Maintenance and Other Expenses in connection with the upkeep of the building	----------	
Interest on Mortgage Obligation	----------	
To--Accounts Payable		----------

(9)

Accounts Payable	----------	
To--Cash		----------

(10)

Real Estate Sale Account	310,000.00	
To--Real Estate		310,000.00
To debit Real Estate Sale Account with sales price of the property sold to..........		

(11)

Real Estate Account	57,000.00	
To--Profit on Sale of Real Estate Account		57,000.00
To transfer from the Real Estate Account the profit on sale of real estate.		

(12)

Cash	160,000.00	
To--Real Estate Sale Account		160,000.00
Cash received in connection with the sale of the property.		

(13)

Mortgage Obligation Outstanding	$150,000.00	
To--Real Estate Sale Account		$150,000.00
Mortgage obligation assumed by the purchaser of the real estate.		

(14)

Rents Collected and Other Miscellaneous Incomes	----------	
Profit on Sale of Real Estate Account	----------	
To--Profit and Loss Account		----------

(15)

Profit and Loss Account	----------	
To--Maintenance and Other Expenses in connection with the upkeep of the property		----------
Interest on Mortgage Obligation		----------

(16)

Profit and Loss Account	57,000.00	
To--A--Capital Account		38,000.00
B-- " "		19,000.00

(17)

A--Capital Account	90,500.00	
B-- " "	71,500.00	
To--Cash		162,000.00

PROFIT AND LOSS ACCOUNT

Maintenance and Other Expenses in connection with the upkeep of the......... property	$---------	Profit from Sale of Real Estate	$57,000.00
Interest on Mortgage Obligation	---------	Rents Collected and Other Miscellaneous Income	---------
Balance--Net Profit carried to the Partners' Accounts			
A $38,000			
B 19,000	57,000.00		
	$57,000.00		$57,000.00

SUMMARY OF CASH TRANSACTIONS

RECEIPTS		DISBURSEMENTS		
Capital contributed by A and B	$105,000.00	Payment in connection with the purchase of real estate		$100,000.00
Rents and other miscellaneous income collected	----------	Payment of expenses in connection with the acquisition of real estate		3,000.00
Cash received on account of sale of real estate	160,000.00	Maintenance and other expenses paid		----------
		Balance paid to the partners		
		A	$90,500.00	
		B	71,500.00	162,000.00
	$265,000.00			$265,000.00

ANSWERS TO QUESTIONS

Answer to Question 31--Briefly stated, a perpetual inventory provides for a system of book records of both quantity and value kept for each class of raw material and finished product. On the debit side of the record the quantity and value of materials received or produced are entered, being in effect a charge to the storekeeper for the materials turned over to him; and on the credit side the quantity and cost value of materials consumed or sold are entered, thus relieving the storekeeper of that part of the materials accounted for. The difference between the debit and credit balances represents approximately the quantity and value of material on hand, which can be verified by the taking of a physical inventory (which is usually undertaken when a particular class of stock is at a low ebb), and any difference can then be adjusted by writing the same off to the Profit and Loss Account of the period through an intermediate account entitled "Inventory Adjustment Account."

The advantages of keeping book or "perpetual" inventories are: (1) that fairly accurate statements of profits can be prepared without necessitating the taking of a physical inventory; (2) it provides the means of keeping a stricter control over the issuance of materials and stock.

The controlling or general ledger accounts opened in connection with a system such as that outlined above are as follows:

RAW MATERIALS STOCK ACCOUNT
General Ledger Controlling Account
(Details carried in subsidiary books or records)

DEBIT WITH

Total invoice value of raw materials purchased--contra a credit to Audited Vouchers Controlling Account.

Total freight and handling charges thereon--contra a credit to Audited Vouchers Controlling Account.

(A column might be introduced on the debit side of account in which the total quantities purchased could be recorded.)

CREDIT WITH

Total cost value (including freight and handling charges) of materials consumed as per production reports--contra a debit to Work in Progress Controlling Account (see below).

Total cost value of materials returned to shippers--contra a debit to Audited Vouchers Controlling Account.

(A column might also be introduced on the credit side of the account in which the total quantities consumed or returned could be recorded.)

The balance of the account is the quantity and cost value of materials on hand at end of period as per summary of balances of substock accounts carried in the subsidiary stock book or record.

WORK IN PROGRESS ACCOUNT
General Ledger Controlling Account
(Details carried in subsidiary books or records)

DEBIT WITH

Total cost value (including freight and handling charges) of materials consumed as per production reports --contra a credit to the Raw Materials Stock Account (see above).

Total wages of workmen directly engaged in the manufacture of the goods--contra a credit to the Audited Vouchers Controlling Account.

Total factory or indirect expenses chargeable to orders in process of manufacture--contra a credit to the Factory Expenses Account.

CREDIT WITH

Total manufacturing cost of finished goods produced during the period--contra a debit to the Finished Product Stock Account (see below).

The balance of the account is the manufacturing cost value of work in progress of manufacture or uncompleted work at any given date. The detailed orders or subwork in progress accounts are carried in a subsidiary book or record and a summary of the total should agree with the balance called for by the controlling account.

FINISHED PRODUCT STOCK ACCOUNT
General Ledger Controlling Account
(Details carried in subsidiary books or records)

DEBIT WITH

Total manufacturing cost value of finished goods produced during the period--contra a credit to the Work in Progress Account (see above).

Total manufacturing cost value of finished goods returned by Customers--contra a credit to the Cost of Goods Sold Account.

CREDIT WITH

Total manufacturing value of finished goods shipped to Customers--contra a debit to Cost of Goods Sold Account.

The balance of the account is the manufacturing cost value of finished goods on hand. The details of the various kinds of finished products on hand are carried in a subsidiary book or record and a trial balance abstracted therefrom should agree with the amount called for by the controlling account.

Answer to Question 32--

(a) Finished products on hand should be valued at the cost of the materials used, productive labor expended and proportion of factory or indirect expenses. The factory cost thus arrived at should be less than the list or selling value - if not a reserve should be created to reduce the inventories to the basis of selling values less a further deduction to cover the estimated cost of selling.

(b) Goods in process of manufacture should be valued at the factory cost to date, represented in materials used, productive labor expended and proportion of the factory expenses chargeable thereto, assuming that the factory has been operating under normal conditions, and that the factory expenses were not out of proportion to the productive labor during that period.

(c) Inventories of Raw Materials on hand should be valued on the basis of cost or market whichever is the lower.

Answer to Question 33--The effect of this treatment in the accounts is to credit Profit and Loss Account with an unearned profit--a profit which may never be realized and commonly referred to as a book profit. The management in this case apparently lost sight of the distinction between a saving and a profit. The proper treatment of such expenditures would be to charge the capital asset accounts with the actual cost--making no entries in respect of the difference between the market and cost value of the tools and equipment manufactured.

Answer to Question 34--

(a) The guaranty constitutes a contingent liability of the company and consequently must be disclosed on the balance sheet. The character of the consideration is immaterial. The fact that the steel and iron material has not been furnished as yet does not affect the contingent liability existing at the balance sheet date.

(b) The contingent liability should be shown in respect of $25,000, being the amount of the claim. It would be preferable, however, to charge current Profit and Loss with the $10,000 and credit a Reserve for Injuries Account, since this portion is a probable loss and should be provided for. If this were done no reference need be made to the remaining $15,000 of the claim.

Answer to Question 35--

(a) The variation in the periodical charge to operating expense under the fixed percentage on a flat basis, fixed percentage on diminishing value, and sinking fund methods is clearly contrasted in Lecture 5, page 12. Note that under the first method the charge is the same each year. Under the second method the charge decreases each year. Under the third method, although the charge to operating expense is the same each year, the credit to the depreciation reserve increases each year, due to the interest accumulations. The periodical charge under the "production" method cannot be stated, as the quantity of production is not known.

(b) In case the company refuses to provide for depreciation and requires the auditor to certify to the balance sheet without such provision being made, the auditor should qualify the property assets and surplus as follows: "(subject to accrued depreciation not provided for)."

Where the statement of profits and income does not include a provision for depreciation and a certificate thereto is required, the surplus net profits for the period should be qualified as follows: "(subject to current depreciation not provided for)."

DISTRIBUTION OF FACTORY BURDEN

1. PRIME COST consists of--

    a. DIRECT MATERIAL--material taken from stock and used in production which can be assigned to a specific order or process.

    b. DIRECT LABOR--time of workmen spent on a specific order or process.

2. In order to ascertain the real cost of production there must be added to this prime cost the proper proportion of burden or general factory expenses.

3. GENERAL FACTORY EXPENSES consist of--

    a. INDIRECT MATERIAL--material taken from stock and used in production but which cannot be assigned to a specific order, such as brooms, oil, and other factory supplies; repair parts; etc.

    b. INDIRECT LABOR--time which cannot be assigned to a specific order such as lost time of productive workmen, foremen, timekeepers, janitors, etc.

    c. EXPENSES connected with the use of the facilities employed in production, such as:

Repairs of buildings, machinery, etc.
Depreciation of buildings, machinery, etc.
Taxes and insurance on buildings, machinery, etc.
Interest on investment in " " "
Power, light, and heat
Factory supplies
Salaries and expenses of cost department
Salaries and expenses of superintendent's office
Etc.

4. In those lines of business where all the costs incurred in production cannot be charged to a process, some other method must be employed to ascertain the actual cost of the various articles produced, or jobs worked on, so as to enable the management to compare costs from time to time in order to determine the operating efficiency, and to value the work in progress and finished product inventories. In order to ascertain the actual cost of production, the burden is distributed over the articles produced or jobs worked upon.

5. No particular method of burden distribution can be applied to all parts of a plant unless conditions are uniform throughout. Each plan will produce accurate results under certain conditions and the extent of its use is limited thereby.

6. PERCENTAGE ON DIRECT WAGES METHOD--

a. PRINCIPLE--Product increases in value according to the amount of labor added thereto. The indirect expenses are incurred in proportion to the amount of labor involved, and this amount of labor is measured by the cost thereof, i.e., wages paid.

b. Under this plan production costs are segregated under three headings:
   (1) Direct Material
   (2) Direct Labor
   (3) Burden, consisting of:
      (a) Indirect Material
      (b) Indirect Labor
      (c) General Factory Expenses

c. METHOD OF OPERATION--Monthly, divide the total burden by the total cost of direct labor. Assuming this percentage to be 80%, then for each dollar of direct labor charged to any order, 80¢ is added for burden.

d. ADVANTAGES--
   (1) Easy to understand and easy to apply
   (2) Distributes all overhead expense incurred during the period
   (3) Produces satisfactory results:
      (a) Where the cost of the direct labor is the most important factor in production
      (b) Where the machinery used is the same throughout the shop as to value and operating cost

(c) Where the work passing through the various departments is uniform
(d) Where the lost-time factor is unimportant

e. DEFECTS--

(1) Most of the general factory expenses depend on the time element and are not incurred in proportion to wages paid
(2) Source of error is variable
(3) Is an average rate and produces unsatisfactory results:
(a) Where the time element is more important than the wages paid
(b) Where labor is not the dominating element in cost.
(c) Where expensive and inexpensive machines are in use side by side
(d) Where high-priced and low-priced operatives are employed
(e) Where low-priced operative using an expensive semi-automatic machine works with high-priced operative using cheap hand machine, or performing hand labor
(f) Where different classes of product pass through the shop and require a variable use of the machinery and operatives
(g) Where the lost time factor is important.

(4) May be approximately correct as to total cost of production but it is inexact as to the cost of the individual articles of jobs produced.

7. HOURLY BURDEN METHOD--

a. PRINCIPLE--As in the case of the percentage on direct wages method, the product increases in value in proportion to the amount of labor added thereto. Similarly, the indirect expenses are incurred in proportion to the amount of labor involved; but the measure of that amount of labor is time--i.e., hours of direct labor--rather than wages paid.

b. Under this plan production costs are segregated under three headings:
(1) Direct Material
(2) Direct Labor
(3) Burden, consisting of:
(a) Indirect Material
(b) Indirect Labor
(c) General Factory Expenses

c. METHOD OF OPERATION--Monthly, the total burden is divided by the number of productive labor hours for the same period to ascertain the burden "per hour." Assuming this rate to be 20¢ per hour, then for each hour of productive labor charged to a specific article or job, 20¢ is added for burden.

d. ADVANTAGES--
- (1) Easy to understand and easy to apply
- (2) Distributes all overhead expense incurred during the period
- (3) Source of error is constant
- (4) Burden is more a function of time than of labor cost
- (5) Produces satisfactory results:
  - (a) Where the time spent on a specific order is the most important factor in the shop operation, since the basis of distribution is the number of hours spent on the order rather than the wages charged to that order
  - (b) Where the machinery used is uniform throughout the shop
  - (c) Where the work passing through the shop is uniform
  - (d) Where the lost time factor is unimportant

e. DEFECTS--Is an average rate and produces unsatisfactory results:
- (1) Where both expensive and inexpensive machines are in use
- (2) Where different classes of product pass through the shop making a variable demand on the machinery and operatives
- (3) Where the lost-time factor is important

8. <u>DIRECT LABOR AND MATERIAL</u>--

a. PRINCIPLE--Cost of material is one of the factors giving rise to indirect expense, and the indirect expense is incurred in proportion to the prime cost

b. METHOD OF OPERATION--Monthly, divide the total burden by the combined cost of direct labor and direct material to ascertain the percentage to be added to the prime cost for burden

c. ADVANTAGES--Most satisfactory results from this method are obtained where direct labor does not exceed the cost of direct material

d. DEFECTS--
- (1) Subject to limitations of all <u>average rate</u> methods
- (2) Not applicable where labor is a material factor in production
- (3) Does not give proper weight to investment--time factors in production

9. <u>OLD MACHINE RATE</u>--

a. PRINCIPLE--Consideration should be given to the value and upkeep of the equipment used in production and the variable demands made thereon by the various orders

b. METHOD OF OPERATION--Each order using the machine is charged at a certain rate per hour of use. This hourly rate is usually based on the probable life of the machine under full work and is used to charge an order with a proportion of the interest on and wear and tear of the machine employed thereon

c. ADVANTAGES--Provides for the variation in the cost of work done on different types of machines in that it recognizes the factor of interest on investment in machinery and the depreciation and upkeep thereof by making a heavier charge for the use of an expensive machine than for the use of a cheaper machine.

d. DEFECTS--
(1) Idle time not provided for
(2) Used to distribute other burden factors through an arbitrary increase in the hour rate
(3) Does not provide for the fundamental principle of burden distribution, viz., every dollar of general factory charges must be burdened onto some order

10. <u>FIXED MACHINE RATE AND SUPPLEMENTARY RATE</u>--

a. PRINCIPLE--Factors making up burden should be analyzed to ascertain their incidence. The shop is divided into its constituent production centers and full play is given to the natural differences between them as far as practicable, instead (as on the averaging plan) of throwing them into one common receptacle or lump sum of shop expenses. Expenses not distributed in this manner, together with idle time, are prorated through a "supplementary rate" over the production of the period.

b. METHOD OF OPERATION--Each machine is considered as an independent "production center." To such centers are allocated all shop expenses which can, on reasonable analysis, be considered chargeable as a composite rent or machine rate for all the factors of production affecting a particular production center. On this basis the hourly machine rate is determined.

Each month there is charged to a Shop Expense Account all expenses incurred by that shop whether they are expenses entering into the machine rate, or general shop expenses which could not be spread over the production centers. This account is credited with the amounts charged to orders through the machine rates for the use of machines. The remaining balance constitutes the supplementary rate which may be spread over the orders on the hourly-burden plan or prorated over the orders in proportion to the amounts previously charged through the machine rate.

The supplementary rate, which consists principally of idle time of machines, becomes an index to the current efficiency of the shop.

c. ADVANTAGES--
(1) Most of the usual "indirect" expenses are distributed as direct charges to a machine, bench, or process, thus eliminating "averaging"
(2) All expenses possible are gathered "at the point of the tool" (or other production center) where they are easily applied to the product operated on

(3) Comparison of the normal cost of production can be made over a series of periods because idle time does not affect the burden rate
(4) The percentage of the supplementary rate indicates the non-utilized capacity of the shop and is a measure of the "waste"
(5) Heterogeneous processes can be carried on side by side without affecting costs.

d. DEFECTS--
(1) Requires an elaborate, intelligent analysis of conditions before the per hour rate for each production center can be fixed in the first instance.
(2) Requires elaborate records to record the cost of orders and to gather the data necessary for the readjustment of machine rates.

11. Numerous modifications of the foregoing methods are in use.

REFERENCES:
Nicholson & Rohrbach, Chapter XI

COMPLETE ACCOUNTING COURSE--PART II

Lecture 10

ESTATE ACCOUNTS

Problem 22 (For class work)

The following is an inventory of B's estate at his death on August 29, 1919:

Cash on hand and in bank	$ 9,031.08
Notes Receivable	11,035.07
Mortgage Loans (secured by Trust Deeds)	20,500.00
Accrued Interest thereon	1,105.85
Stocks at market values at August 29, 1919	19,502.75
Bonds " " " " " " "	35,425.35
Life Insurance Policies (face value)	10,000.00
Loans to Sundry Persons	5,000.00
Household Goods	2,000.00
Bills Payable (secured by the above-mentioned stocks)	15,000.00
Sundry Liabilities	5,000.00

(a) Prepare the opening entries for the executor's books.

(b) Give expression to the following transactions: legacies paid, $7,500; bonds disposed of, $34,050; funeral expenses, $1,025; probate court costs, $987.50; attorney's fees, $1,000; accountant's fees, $350.

(c) Prepare a charge and discharge statement.

Problem 23

At C's death on June 15, 1918, the net value of his estate was $300,000 and the executor's books opened on that basis.

During the year ending June 15, 1919, the following transactions took place:

PARTICULARS	INVENTORY VALUE	REALIZED
Missouri Pacific First Mortgage Bonds	$ 90,000.00	$ 94,000.00
C. & N. W. Ry. Co. First Mortgage Bonds	125,000.00	131,000.00
Loans to Sundry Persons	39,000.00	24,500.00
Preferred Stock in the New Manufacturing Co.	35,000.00	40,000.00
Investment in the firm of C & D	34,000.00	40,000.00
	$323,000.00	$329,500.00

Liabilities estimated at $23,000 were found to be actually $26,000, which were paid on September 1, 1918.

Prepare the necessary journal and cash book entries in respect of the foregoing transactions.

Problem 24

A died on July 1, 1918, leaving:

Cash on hand	$ 900.00
Bank Overdraft	2,250.00
Life Insurance Policy (on which he has borrowed $1,000, with interest at 5%; the loan was made three years ago; no interest has been paid)	5,000.00
Preferred Stock in Wilson Manufacturing Co.	100,000.00
Loan to John Smith (interest at 6% payable January 1 and July 1. Interest paid to January 1, 1918)	25,000.00
First Mortgage 5% Bonds of the Western Lumber Co., interest payable March and September 1 (bonds sold on October 1 for $300,000)	291,000.00
Sundry Liabilities	8,000.00
Funeral Expenses	900.00
Accrued interest on Bonds and Loans--not included in above	--------
Dividend received on the Wilson Mfg. Co. Preferred Stock	10,000.00

The net income is payable to the wife.

The insurance policy was paid on August 1, 1918, the amount of the loan with the accrued interest being deducted in the settlement. All liabilities were paid, and the income collected to December 31, 1919, was paid to A's wife--per terms of will.

Prepare all of the entries to give expression to the foregoing transactions and set up the necessary ledger accounts.

MISCELLANEOUS QUESTIONS

Question 46--Define an "account current" and make out such an account for A & Co. in respect of the following transactions with B & Co.

1919			
April	1	Goods sold to B & Co.	$ 500.00
May	1	Received cash from B & Co.	220.00
June	15	Goods purchased from B & Co.	1,250.00
July	1	Cash paid to B & Co.	830.00
July	15	" " " " "	750.00
August	1	Goods purchased from B & Co.	1,250.00
August	15	" " " " "	550.00

The account should be made up as of August 31, 1919, interest to be calculated at the rate of 6% per annum upon the basis of 360 days to a year.

Question 47--In a large manufacturing company with several factories and branch offices, a separate set of books is carried at each point--being controlled, however, through the medium of the general office books. In the balance sheet prepared at the end of the year, the Net Branch Office Account as shown on the head office books is incorporated as part of the Sundry Debtors. Would you consider it proper to deal with the branch office accounts in this way?

Question 48--State in the form of journal entries on the books of A Company the following transactions:

(a) Insurance collected by the company, on account of fire, $76,500 applying on building, fixtures, and merchandise. The building is valued at $50,000, fixtures at $8,950, and merchandise at $30,000

(b) Increase in value of real estate, $15,000

(c) Instalment notes given by the company for $40,436.50, on purchase of real estate; face of notes include interest charges of $436.50, up to and including maturity of notes

Question 49--State briefly what information should be submitted by the executor to the probate court, and the form in which the accounts might be submitted.

Question 50--What is your understanding of the following terms:

(a) Capital surplus
(b) Surplus profits available for dividends
(c) Organization or preliminary expenses

Solution to Problem 22

JOURNAL ENTRIES

(1)

Cash on Hand and in Bank	$ 9,031.08	
Notes Receivable	11,035.07	
Mortgage Loans	20,500.00	
Accrued Interest thereon	1,105.85	
Stocks	19,502.75	
Bonds	35,425.35	
Life Insurance Policies	10,000.00	
Loans to Sundry Persons	5,000.00	
Household Goods	2,000.00	
To--Bills Payable		$15,000.00
Sundry Liabilities		5,000.00
Estate Account		93,600.10

To record inventory of estate of B as filed in Probate Court on...........

(2)

Estate Account	1,375.35	
To--Bonds		1,375.35

Loss on sale of bonds.

SUMMARY OF CASH TRANSACTIONS

PARTICULARS	PRINCIPAL	INCOME	PARTICULARS	PRINCIPAL	INCOME
Cash on hand and in bank Aug. 29, 1919	$ 9,031.08	------	Legacies	$ 7,500.00	------
Proceeds from the sale of bonds	34,050.00	------	Funeral Expenses	1,025.00	------
			Probate Court Costs	987.50	------
			Attorney's Fees	1,000.00	------
			Accountant's Fees	350.00	------
			Bills Payable	15,000.00	------
			Sundry Liabilities	5,000.00	------
			Balance--cash on hand and in bank at end of period	12,218.58	------
	$43,081.08	------		$43,081.08	------

B'S ESTATE CHARGE AND DISCHARGE STATEMENT
(Date)

CHARGE			DISCHARGE		
ESTATE AT THE DEATH OF THE TESTATOR, AUG. 29, 1919:			PAYMENTS OUT OF PRINCIPAL:		
Cash		$ 9,031.08	Legacies	$ 7,500.00	
Notes Receivable		11,035.07	Funeral Expenses	1,025.00	
Mortgage Loans		20,500.00	Probate Court Costs	987.50	
Accrued Interest thereon		1,105.85	Attorney's Fees	1,000.00	
Stocks		19,502.75	Accountant's Fee	350.00	
Bonds		35,425.35			
Life Insurance Policies		10,000.00	Total payments of		$10,862.50
Loans to Sundry Persons		5,000.00			
Household Goods		2,000.00	LOSS ON REALIZATION OF BONDS:		
			Book value $35,425.35 sold		
		$113,600.10	for $34,050, or a loss of		1,375.35
LESS--Liabilities:					
Bills Payable	$15,000.00		ESTATE AT CLOSE OF PERIOD:		
Sundry Liabilities	5,000.00	20,000.00	Cash	$12,218.58	
			Notes Receivable	11,035.07	
Per Inventory		$93,600.10	Mortgage Loans	20,500.00	
			Accrued Interest	1,105.85	
			Stocks	19,502.75	
			Life Ins. Policies	10,000.00	
			Loans to Sundry Persons	5,000.00	
			Household Goods	2,000.00	81,362.25
		$93,600.10			$93,600.10

Solution to Problem 18

ENTRIES UPON BRANCH OFFICE BOOKS

(1)

	Debit	Credit
Merchandise Purchased	$11,083.77	
To--Home Office Account		$11,083.77
For cost value of merchandise received during the year from the warehouse.		

(2)

	Debit	Credit
Freight on Purchases	911.03	
To--Home Office Account		911.03
Freight prepaid by home office on materials purchased.		

(3)

	Debit	Credit
Salaries and Other Expenses	7,585.56	
To--Accounts Payable		7,585.56
Total of salaries and other expenses during the year as per voucher record.		

(4)

	Debit	Credit
Accounts Payable	6,987.45	
To--Cash		6,987.45
Total of salaries and other expenses actually paid during the year.		

(5)

	Debit	Credit
Customers' Accounts	30,811.74	
To--Sales Account		30,811.74
Total sales during the year as per sales record or journal.		

(6)

	Debit	Credit
Cash	26,900.41	
To--Customers' Accounts		26,900.41
Total of customers accounts collected during the year as per cash book.		

(7)

	Debit	Credit
Proportion of Home Office Management Salaries and Expenses	675.00	
To--Home Office Account		675.00
Charge rendered by the Home Office representing this Branch's proportion of the Home Office salaries and expenses during the year ended June 30, 1919.		

(8)

Branch No. 2 (or the Home Office Account)	$1,318.11	
To--Merchandise Purchased		$1,220.00
Freight on Purchases		98.11

Cost value (including freight charges thereon) of merchandise shipped to Branch No. 2.

(9)

Merchandise Purchased	8,378.11	
To--Accounts Payable		8,378.11

Merchandise purchased direct by the branch office, as per voucher record.

(10)

Accounts Payable	8,378.11	
To--Cash		8,378.11

Total of outside purchases of merchandise which were paid for during the year ending June 30, 1919.

(11)

Inventory of Merchandise on hand at June 30, 1919	1,103.27	
To--Trading Account		1,103.27

To take up the inventory of materials on hand at June 30, 1919.

CLOSING ENTRIES

(1)

Sales Account	$30,811.74	
To--Trading Account		$30,811.74

(2)

Trading Account	19,054.80	
To--Merchandise Purchased Account		18,241.88
Freight on Purchases		812.92

(3)

Trading Account	12,860.21	
To--Profit and Loss Account		12,860.21

(4)

Profit and Loss Account	8,260.56	
To--Salaries and Other Expenses		7,585.56
Proportion of Home Office Management, Salaries, and Expenses		675.00

Profit and Loss Account	$ 4,599.65	
To--Home Office Account		$ 4,599.65
To transfer net profit of branch to Home Office Account.		

The statements ordinarily sent to the Home Office after the Branch Office books are closed are as follows:

BRANCH OFFICE LEDGER
TRIAL BALANCE (After Closing)
JUNE 30, 1919

Home Office Account (including the charge of $1,318.11 to Branch No. 2 above referred to)		$15,951.34
Customers' Accounts (supported by a detailed list showing the status of each account at June 30, 1919)	$ 3,911.33	
Cash on Hand and in Bank (supported by a statement showing the composition of the amount)	11,534.85	
Inventory of Merchandise on Hand at June 30, 1919 (supported by a detailed inventory properly certified to by the Manager and Bookkeeper respectively)	1,103.27	
Accounts Payable (with a detailed list of the items appended to the Trial Balance)		598.11
	$16,549.45	$16,549.45

TRADING AND PROFIT AND LOSS STATEMENT
FOR YEAR ENDING JUNE 30, 1919
TRADING ACCOUNT

Purchases of Merchandise during the Year		$19,461.88	Sales	$30,811.74
Freight Charges on Merchandise purchased		911.03		
		$20,372.91		
LESS--Mdse. shipped to Branch No. 2	$1,318.11			
Inventory of Mdse. on hand at June 30, 1919	1,103.27	2,421.38		
Cost of Goods Sold		$17,951.53		
Balance--Gross Profits carried to Profit and Loss Account		12,860.21		
		$30,811.74		$30,811.74

PROFIT AND LOSS ACCOUNT

Salaries and Other Expenses	$ 7,585.56	Gross Profit brought down from Trading Account	$12,860.21
Proportion of Home Office Salaries and Expenses	675.00		
Balance--Net Profits from Trading for the year ending June 30, 1919, carried to the Home Office Account	4,599.65		
	$12,860.21		$12,860.21

SUMMARY OF BRANCH OFFICE ACCOUNT WITH THE HOME OFFICE

Merchandise shipped to Branch No. 2	$ 1,220.00	Merchandise received from Home Office	$11,083.77
Freight Charges thereon	98.11	Freight charges thereon	911.03
Balance as per Trial Balance	15,951.34	Proportion of Home Office Management Salaries and Expenses	675.00
		Balance of Profit and Loss Account as per detailed statement appended hereto	4,599.65
	$17,269.45		$17,269.45

ENTRIES UPON HOME OFFICE BOOKS

(1)

Branch No. 1 Office Account	$11,994.80	
To--Finished Product		$11,083.77
Freight on Branch Shipments		911.03

To record materials shipped to Branch No. 1 at cost and prepaid freight thereon.

(2)

Branch No. 1 Office Account	675.00	
To--Management, Salaries, and Expenses		675.00

To charge Branch No. 1 with proportion of home office management salaries and expenses.

(3)

Branch No. 2 Office Account	1,318.11	
To--Branch No. 1 Office Account		1,318.11

Materials shipped at cost from Branch No. 1 to Branch No. 2, including freight charges from home office to Branch No. 1.

Branch No. 1 Office Account	$ 4,599.65	
To--Branch No. 1 Profit and Loss Account		$ 4,599.65
To take up net profit of Branch No. 1 as per trading and profit and loss account for the year ending June 30, 1919.		

Solution to Problem 19

THE GENERAL MANUFACTURING COMPANY
BALANCE SHEET, DECEMBER 31, 1918

ASSETS

CURRENT ASSETS:			
Cash Accounts		$ 202,615.00	
Accounts Receivable		469,908.00	
Inventories		1,043,817.00	
Other Current Assets		46,940.00	$1,763,280.00
DEFERRED CHARGES:			
Interest, Insurance, etc., Pre-paid		$ 19,644.00	
Bond Discount not Amortized		2,500.00	22,144.00
INVESTMENTS:			
Stocks of Other Companies		$ 120,000.00	
Miscellaneous Bonds and Stocks		12,250.00	
Liberty Bonds		150,000.00	282,250.00
SINKING FUND FOR BONDS			10,000.00
LAND, BUILDINGS, MACHINERY, ETC:			
Land		$ 84,797.00	
Construction in Progress		30,158.00	
Buildings	$248,285.00		
Office Furniture and Fixtures	9,966.00		
Machinery and Equipment	92,790.00		
Delivery Equipment	19,116.00		
Other Fixed Assets	16,380.00		
	$386,537.00		
LESS--Depreciation Reserve	122,620.00	263,917.00	378,872.00
GOOD-WILL			350,000.00
			$2,806,546.00

LIABILITIES

CURRENT LIABILITIES:			
Notes Payable		$ 875,000.00	
Accounts Payable		91,191.00	
Accrued Interest, Taxes, and Wages		9,212.00	
Other Current Liabilities		4,550.00	$ 979,953.00
BONDS ISSUED AND OUTSTANDING			500,000.00
CONTINGENT RESERVE			75,000.00
NET WORTH:			
Capital Stock, 10,000 shares par value $100 each		$1,000,000.00	
Surplus at January 1, 1918	$210,500.00		
Profits, Year Ending December 31, 1918	66,093.00		
	$276,593.00		
LESS--Dividends Paid	25,000.00	251,593.00	1,251,593.00
			$2,806,546.00

THE GENERAL MANUFACTURING COMPANY—WORKING SHEET FOR PREPARATION OF BALANCE SHEET—DECEMBER 31, 1918

	HOME OFFICE BALANCE SHEET	CHICAGO PLANT	ALL BRANCH HOUSES	TOTALS	INTEROFFICE ELIMINATION Debits	INTEROFFICE ELIMINATION Credits	COMPANY BALANCE SHEET
ASSETS							
CURRENT ASSETS:							
Cash	$ 58,000.00	$ 39,710.00	$ 4,905.00	$ 102,615.00	(1)$100,000.00	$	$ 202,615.00
Accounts Receivable	294,300.00	122,745.00	44,463.00	461,508.00	(2) 8,400.00		469,908.00
Inventories	773,200.00	190,025.00	40,312.00	1,003,537.00	(2) 11,085.00) (1) 29,195.00)		1,043,817.00
Other Accounts	43,650.00	3,290.00		46,940.00			46,940.00
Total Current Assets	$1,169,150.00	$355,770.00	$ 89,680.00	$1,614,600.00			$1,763,280.00
DEFERRED CHARGES:							
Interest, Insurance, etc.	$ 12,590.00	$ 6,374.00	$ 680.00	$ 19,644.00			$ 19,644.00
Bond Discount	2,500.00			2,500.00			2,500.00
Total Deferred Charges	$ 15,090.00	$ 6,374.00	$ 680.00	$ 22,144.00			$ 22,144.00
INVESTMENTS:							
Stocks of Other Companies	$ 120,000.00	$	$	$ 120,000.00			$ 120,000.00
Miscellaneous Bonds and Stocks	12,250.00			12,250.00			12,250.00
Liberty Bonds	125,000.00	25,000.00		150,000.00			150,000.00
Total Investments	$ 257,250.00	$ 25,000.00	$	$ 282,250.00			$ 282,250.00
SINKING FUND FOR BONDS	$ 10,000.00	$	$	$ 10,000.00			$ 10,000.00
FIXED ASSETS:							
Land	$ 78,410.00	$	$ 6,387.00	$ 84,797.00			$ 84,797.00
Buildings	183,540.00	38,400.00	26,345.00	248,285.00			248,285.00
Machinery and Equipment	65,450.00	15,460.00	11,880.00	92,790.00			92,790.00
Office Furniture and Fixtures	7,320.00	1,190.00	1,456.00	9,966.00			9,966.00
Delivery Equipment	5,425.00	11,050.00	2,641.00	19,116.00			19,116.00
Construction in Progress	30,158.00			30,158.00			30,158.00
Other Fixed Assets	16,380.00			16,380.00			16,380.00
Depreciation Reserve	*97,700.00	*18,480.00	*6,440.00	*122,620.00			*122,620.00
Total Fixed Assets	$ 288,983.00	$ 47,620.00	$ 42,269.00	$ 378,872.00			$ 378,872.00
GOOD-WILL	$ 350,000.00	$	$	$ 350,000.00			$ 350,000.00
CURRENT ACCOUNTS—PLANT	356,750.00			356,750.00		*(1)$356,750.00	
" " BRANCHES	135,800.00			135,800.00		*(2) 135,800.00	
TOTAL ALL ASSETS	$2,583,023.00	$434,764.00	$132,629.00	$3,150,416.00			$2,806,546.00
LIABILITIES							
CURRENT LIABILITIES:							
Notes Payable	$ 695,000.00	$180,000.00	$	$ 875,000.00			$ 875,000.00
Accounts Payable	52,800.00	23,899.00	14,492.00	91,191.00			91,191.00
Accrued Interest, Taxes, and Wages	5,380.00	2,010.00	1,822.00	9,212.00			9,212.00
Other Current Liabilities	3,250.00	1,300.00		4,550.00			4,550.00
Total Current Liabilities	$ 756,430.00	$207,209.00	$ 16,314.00	$ 979,953.00			$ 979,953.00
BONDS ISSUED AND OUTSTANDING	$ 500,000.00	$	$	$ 500,000.00			$ 500,000.00
NET WORTH:							
Capital Stock	$1,000,000.00	$	$	$1,000,000.00			$1,000,000.00
Contingent Reserves	75,000.00			75,000.00			75,000.00
Surplus Account	210,500.00			210,500.00			210,500.00
Profits year to Date	66,093.00			66,093.00			66,093.00
Dividends	*25,000.00			*25,000.00			*25,000.00
Total Net Worth	$1,326,593.00	$	$	$1,326,593.00			$1,326,593.00
HOME OFFICE ACCOUNT—PLANT	$	$227,555.00	$	$ 227,555.00	(1)$227,555.00		$
" " " BRANCHES			116,315.00	116,315.00	(2) 116,315.00		
TOTAL ALL LIABILITIES	$2,583,023.00	$434,764.00	$132,629.00	$3,150,416.00	$492,550.00	$492,550.00	$2,806,546.00

*Red

MEMORANDUM JOURNAL ENTRIES

(1)

Cash	$100,000.00	
Inventories	29,195.00	
Plant Home Office Account	227,555.00	
To--Home Office Account		$356,750.00

Eliminating Plant current account and placing on working sheet difference in cash and inventories. (Reconciliation shows cash and goods in transit, as above.)

(2)

Accounts Receivable	84,000.00	
Inventories	11,085.00	
Home Office Account on Branch Books	116,315.00	
To--Branch Accounts on Home Office Books		135,800.00

Eliminating the branch inter-office accounts.

ANSWERS TO QUESTIONS

Answer to Question 36--In order to meet the requirements of the management and record the profit or loss from the operation of each department, an accounting system somewhat along the following lines might be adopted:

1. GENERAL SALES ACCOUNT--The total sales as recorded in the sales record should be posted to the credit of a Sales Account to be kept in the general ledger, and the distribution of the sales by departments should be made in a subsidiary or analysis record. The total of the departmental sales accounts as shown by the latter record should agree with the balance called for by the Sales Account; hence it follows that the latter operates as a controlling account.

2. GENERAL COST OF GOODS SOLD ACCOUNT--The total cost of goods sold should be posted to the debit of a "Cost of Goods Sold Account" to be opened in the general ledger. The distribution according to departments should be made through the medium of a subsidiary record. The total of the cost of goods sold by all departments should agree with the balance called for by the general ledger controlling account.

3. DEPARTMENTAL EXPENSE ACCOUNT--The total expenses of each department should be carried to appropriate departmental expense controlling accounts opened for each department in the general ledger in order to receive the charges coming from the various books of original entry. The analysis or distribution of the departmental expenses can be accomplished through the introduction of an abstract or analysis record, the total of the expenses as distributed in that record agreeing with the amount shown in the general ledger.

The difference between the proceeds from sales (recorded in total in the General Sales Account) and the cost of goods sold (summarized in the General Cost of Goods Sold Account) would represent the gross profit on the business

done. From the latter amount should be deducted the departmental expenses, the balance representing the departmental profits which are carried to the General Profit and Loss Account, in which account the general management expenses, miscellaneous income, and net profits from operation are shown. The following is an illustration of the manner in which the statement of profits may be prepared:

STATEMENT OF PROFITS AND INCOME
MONTH OF ....

DEPARTMENTAL PROFIT AND LOSS ACCOUNT

PARTICULARS	DEPT. A	DEPT. B	DEPT. C	TOGETHER
Sales	$110,000.00	$125,000.00	$75,000.00	$310,000.00
DEDUCT--Cost of Goods Sold	80,000.00	93,000.00	60,000.00	233,000.00
BALANCE--Gross Profits	$ 30,000.00	$ 32,000.00	$15,000.00	$ 77,000.00
DEPARTMENTAL EXPENSES:				
Salaries	$ 8,000.00	$ 9,000.00	$ 4,000.00	$ 21,000.00
Rent	1,000.00	1,000.00	500.00	2,500.00
Telephone and Telegraph	500.00	750.00	250.00	1,500.00
Stationery and Printing	500.00	250.00	250.00	1,000.00
Traveling Expenses	3,000.00	4,000.00	2,500.00	9,500.00
Commissions	1,000.00	500.00	500.00	2,000.00
Miscellaneous Expenses	1,000.00	500.00	1,000.00	2,500.00
TOTAL Departmental Expense	$ 15,000.00	$ 16,000.00	$ 9,000.00	$ 40,000.00
Departmental Profits carried to General Profit and Loss Account	$ 15,000.00	$ 16,000.00	$ 6,000.00	$ 37,000.00

GENERAL PROFIT AND LOSS ACCOUNT

Management Salaries	$10,000.00	Departmental Profits brought down:		
General Office Salaries and other expenses	7,500.00	A	$15,000.00	
		B	16,000.00	
Interest on Bank Loans	8,200.00	C	6,000.00	
				$37,000.00
	$25,700.00			
Surplus Net Profits carried to Surplus Account	13,200.00	Interest received on Bank deposits, etc.		700.00
		Rents Collected (net)		1,200.00
	$38,900.00			$38,900.00

Answer to Question 37--The payments of $11,037.27 for real estate, personal property, and corporation taxes for the year 1918 should be charged against the "Accrued Taxes Account," and any difference between the actual amount of the taxes paid and the provisions accrued in respect thereof should be adjusted by a credit or debit to the Accrued Taxes Account as the case may be and in many cases per contra, debited or credited to Taxes Account (a sub profit and loss account).

Answer to Question 38--

(a) Cash dividends represent the dividends declared by the board of directors and paid to the stockholders in cash.

(b) Bonuses to officers generally represent additional compensation as a reward for bringing about a "good showing" for the period. They are most frequently paid in cash, although in some instances they are paid in stock.

(c) Stock dividends represent the dividends declared by the board of directors and paid to the stockholders in stock. They may be payable in preferred stock or common stock, depending on the terms of the resolution adopted by the directors.

(d) Cash or stock dividends must be declared by the board of directors. When declared, they become a liability of the corporation payable at the dates specified in the resolution. Consequently they should be recorded on the books notwithstanding that the date of payment may be subsequent to the end of the current fiscal period.

(e) Entries to be made are:

CASH DIVIDEND

(1)

Surplus	$--------	
To--Dividends Payable		$--------
Dividend #8 payable .... declared by resolution of board of directors adopted....... See page....of minute book.		

(2)

Dividends Payable	--------	
To--Audited Vouchers		--------

(3)

Audited Vouchers	--------	
To--Cash		--------

STOCK DIVIDEND

(1)

Surplus	$--------	
To--Dividends Payable		$--------
To record stock dividend #1 payable........ declared by resolution of board of directors adopted....... See minute book page....		

(2)

Dividends Payable	$--------	
To--Capital Stock		$--------
To record issuance of stock certificates in payment of stock dividend #1.		

BONUS TO OFFICERS

(1)

Bonus to Officers	$--------	
To--Audited Vouchers		$--------

(2)

Audited Vouchers	--------	
To--Cash		--------

(3)

Profit and Loss	--------	
To--Bonus to Officers		--------

Answer to Question 39--

Preferred stock dividends in arrears are not a liability of the corporation and hence should not be stated as such. The better practice is to refer to them in a footnote to the balance sheet, as the information is essential in order to show the position of the common stock.

Answer to Question 40--

(a) Unpaid Subscriptions to Capital Stock may be shown as a deduction from the capital stock issued and outstanding or it may be shown as Unpaid Subscriptions. In the latter case the asset is stated between the Capital and Current Assets. If the amount involved is small and will be paid in shortly it may be proper to include same among the current assets.

(b) Unissued Capital Stock is non-existent and consequently must be deducted from the nominal issue in order to show the Capital Stock Issued and Outstanding. Two forms may be followed, viz.:

(1)

Capital Stock Authorized:		
1,000 shares par value $100.00	$100,000.00	
Issued and Outstanding		$80,000.00

(2)

Capital Stock Authorized:		
1,000 shares par value $100.00	$100,000.00	
Less--Unissued	20,000.00	
Issued and Outstanding		$80,000.00

(c) Dividends declared and unpaid represent a liability of the corporation to the stockholders to be paid at the date specified in the resolution declaring the dividend. Cash dividends are part of the current liabilities and should be so shown on the balance sheet. Stock dividends are shown immediately following the current liabilities, since their payment will not affect the working capital. It is generally considered the better practice to state on the balance sheet the date of payment.

ESTATE ACCOUNTING

The term "fiduciary accounting" applies most often to the accounting for the estates of deceased persons, although the term is also used in connection with various kinds of trusts and funds arising in the course of ordinary business procedure.

In estate accounting the chief difficulties center about the question, "What is income?" This question has never been satisfactorily settled, its answer having been given in numerous conflicting decisions of state courts. In practice, when the question arises, a ruling from the probate (or surrogate) court is obtained and followed, regardless of the correctness of the accounting theory involved.

The will of a deceased person names one or more executors, and in case the estate is not to be divided at once, one or more trustees. An administrator is appointed by the probate court should no will be found. Their duties are defined by the will or by the court. The first step is to file an inventory of the estate based usually on market values at date of death. Securities and other properties may be appraised if their value is not otherwise obtainable. The values thus ascertained, together with the liabilities at date of death, form the opening entry for the executor's books, the net amount being credited to "Estate Account." The Estate Account is a capital account and will be credited and debited for any increases or decreases in capital.

Principal or Corpus consists of the net estate left by the testator and includes all accruals up to and including the date of death. The property left by the testator, not the value placed thereon for probate purposes, is the essential point. Consequently, when realized, any excess or deficiency between the sale price and the probated value is principal, not income.

Income consists of the revenue obtained from the principal and accruing after the testator's death. It differs from the term "profits," as the latter is ordinarily understood, in that the profit or loss arising from the realization of the assets comprising the principal remains principal, and no part thereof becomes income. Furthermore, the interest collected on a bond is income although the bond itself is sold at a loss, such loss being chargeable to the principal.

The more common items are classified as follows:

1. Accrued items (taxes, interest, etc.) are usually computed to the date of death as a part of or deduction from principal, and thereafter as an addition to or subtraction from income. Practice varies considerably, but there would seem to be no doubt of the best accounting procedure.

2. Cash dividends declared before and paid after death are in most cases considered part of principal.

3. Stock dividends declared before or after death are generally regarded as principal.

4. Premiums and discounts on bonds. If discounts are amortized over the life of the bonds, income will be credited each year with a certain portion thereof. The amortization of premiums would require the setting aside from income a specified sum each year. In some jurisdictions the question is avoided by neglecting any provision for discount or premium.

Items not subject to dispute which are charged or credited to principal, are:

1. Additional liabilities of testator incurred prior to date of death
2. Losses or profits on sale of real and personal property
3. Funeral expenses
4. Expenses of probating, etc.
5. Legacies

Items charged or credited to income are:

1. Cash dividends declared after death
2. Bond and other interest accruing after date of death
3. Current estate expenses (auditing, legal, etc.)
4. Repairs and maintenance
5. Provision for depreciation, depletion, etc., except where the will indicates an intention to pass the income without first providing for depreciation or depletion of the corpus.

LIFE TENANT or INCOME BENEFICIARY--person who is entitled to receive the income from the estate.

REMAINDERMAN--person to whom the corpus passes.

LEGATEE--person who receives something specifically willed to him by the testator, provided the testator still owns that thing. For instance, if a specific security is willed but has been disposed of prior to the testator's death, the legacy lapses; the equivalent value does not pass.

ADVANCE--If the testator has made a gift with the intention that the amount thereof shall be deducted from the receiver's share in the estate, such gift is termed an advance. It is added back for the purpose of determining the total estate and deducted from the receiver's share therein. Should the advance exceed the receiver's share, it is not added back to the estate which would then be divided among the others. The interest of the party to whom the advance had been made would cease, but no refund need be made.

At the end of the first year or sooner, as directed by the court, the executor submits a report of his administration to the court showing the disposition of various assets, the acquisition of others, and in general the course of funds through his hands. One form of statement--the statement of charge and discharge--is outlined below:

ESTATE OF WILLIAM ROE
STATEMENT OF FINAL ACCOUNTING
BY JOHN DOE, EXECUTOR

I CHARGE MYSELF WITH:

AS TO PRINCIPAL:		
Assets as per Appraisal:		
Cash	$----	
Debtors	----	
Mortgages	----	
Bonds	----	
Corporation Stocks	----	$----
Assets Discovered after Appraisal:		
Insurance Policies	$----	
Real Estate	----	----
Increase in Value of Assets Sold:		
Stock	$----	
Bonds	----	----
AS TO INCOME:		
Income Collected:		
Rent	$----	
Interest on Bonds	----	
Interest on Notes	----	
Dividends on Stock	----	----
		$----
BALANCE OF ESTATE CARRIED FORWARD:		
Principal	$----	
Income	----	$----
		$----

I CREDIT MYSELF WITH:

AS TO PRINCIPAL:		
Liabilities Liquidated:		
Debts Paid	$----	
Bank Loan Paid	----	$----
Expenses chargeable to Principal:		
Funeral Expenses	$----	
Probate Charges	----	
Legal Expenses	----	
Executor's Commission	----	----
Decrease in Value of Assets Sold:		
Mortgages	$----	
Stocks	----	
Real Estate	----	----
Balance of Principal:		
Cash	$----	
Bonds	----	----
		$----
AS TO INCOME:		
Expenses Chargeable to Income:		
Repairs to Real Estate	$----	
Taxes on Real Estate	----	
Executor's Commission	----	----
Balance of Income		----
		$----
LEGACY PAID GEORGE ROE		$----
DISTRIBUTION:		
1/3 to widow	$----	
1/2 to George, son	----	
1/6 to Arabella, daughter	----	----
		$----

It will be noted that the statement divides itself into two parts, the first including the transactions up to the point of distributing the legacies, and the balance of the estate. The second part shows the distribution as between the legatees and heirs. Should the statement be prepared before the final distribution, the last section will, of course, be omitted and any payments of legacies shown under principal credits above. Liabilities at date of death may be deducted from the total of assets originally charged in order that the net inventory figure may appear on the statement.

The books of an executor or trustee are usually very simple, the only variation from standard practice arising in case of the cash book which may be provided with two money columns, one for principal and the other for income. In this way the balances of principal and income cash on hand may be ascertained, although both may be kept in the same bank account.

REFERENCES:

Howes, Income and Principal
Hardcastle, Accounts of Executors and Trustees

COMPLETE ACCOUNTING COURSE--PART II

Lecture 11

BALANCE SHEET CONSTRUCTION

Problem 25

A corporation known as the A B Mfg. Co. purchased a plant and commenced manufacturing a bulk product on January 1, 1918. The following trial balance was abstracted from the books at January 31, 1918.

	DEBITS	CREDITS
Real Estate	$ 67,200.00	
Buildings	481,215.00	
Machinery	211,380.00	
Customers' Accounts	109,500.00	
Accounts Payable		$ 66,960.00
Bank Account	44,370.00	
Shop Expenses	4,395.00	
Heat and Power	3,360.00	
Insurance Premiums (policies cover the period of 3 years from January 1, 1918)	7,035.00	
Sales		127,050.00
Labor	33,735.00	
Supplies	11,460.00	
Raw Materials purchased	168,675.00	
Office Furniture and Fixtures	3,750.00	
Discount on Sales	630.00	
Office and Management Salaries	3,900.00	
Freight on Sales	705.00	
Interest on Notes Payable (covering period from January 1 to March 31, 1918)	900.00	
Notes Payable		60,000.00
Capital Stock		600,000.00
First 6% Bonds		300,000.00
General Expenses	1,800.00	
	$1,154,010.00	$1,154,010.00

Prepare the following:

(a) Statement showing cost of product manufactured and average cost "per pound"--12,000,000 pounds being produced

(b) Finished product account--(7,000,000 pounds on hand at January 31, 1918)

(c) Statement of profit and loss account for month of January, 1918

(d) Balance sheet as at January 31, 1918.

No entries were made in the books in respect of the following items:

1. Raw materials used--per storekeeper's distribution reports, $121,095
2. Accrued wages January 31, 1918, $4,500
3. Estimated freight allowances to customers at January 31, 1918, equivalent to approximately 5% of the total uncollected accounts at that date
4. Estimated allowances to be made on account of cash discounts, $1,750
5. Accrued bond interest for the month of January
6. Depreciation for the month of January at the following annual rates:
   (a) Buildings, 2 1/2%
   (b) Machinery, 7 1/2%
   (c) Furniture and Fixtures, 10%
7. The storekeeper reports the following issues during the month:
   (a) Factory office supplies, $735
   (b) Shop supplies, $7,080

Problem 26

From the following trial balances and additional data taken after the closing of the books of The Chicago Cottage Construction Company, prepare a balance sheet in proper form, making whatever adjustments therein you think necessary, and submit also the adjustments you would make on the books.

TRIAL BALANCE AFTER CLOSING, DECEMBER 31, 1918

Cash (Banks)	$ 45,000.00	
Buildings, Land, Machinery, Tools, and Office Supplies	422,000.00	
Patents, Copyrights, Trade Secrets, and Good-Will	125,000.00	
First Mortgage, 20-year, 6% Bonds		$ 200,000.00
Bills Payable		100,000.00
Patterns, Molds, Drawings, etc.	30,000.00	
Inventories:		
Raw Materials	20,000.00	
Work in Progress	40,000.00	
Completed Cottages	15,000.00	
Accounts Receivable	230,000.00	
Prepaid Insurance and Advertising	1,050.00	
Bills Receivable	60,100.00	
Furniture and Fixtures	4,700.00	
Leaseholds	1,000.00	
Accounts Payable		89,123.47
Reserve for Depreciation		55,250.00
Reserve for Bad Debts		13,000.00
Claims Against Transportation Companies	3,792.00	
Houses and Land for Employees	46,600.00	
Unissued Stock, Common	10,000.00	
Investment of Sinking Fund	18,107.08	
Prepaid Commissions	8,140.00	
Illinois Company Preferred Stock (100 shares)	7,580.00	
Reserve for Pending Lawsuits		20,000.00
Prepaid Interest	500.00	
Treasury Stock, Preferred	30,000.00	
Bond Sinking Fund Reserve		18,107.08
Dividends Payable		10,000.00
Sundry Debtors	21,378.34	
Cash (deposited with Fiscal Agent)	2,450.00	
Deposits on Bids	12,500.00	
Liberty Bonds	60,000.00	
Accrued Taxes		976.00
Reserve for Fire Losses		25,000.00
Common Stock		200,000.00
Preferred Stock		200,000.00
Surplus		283,440.87
	$1,214,897.42	$1,214,897.42

From an analysis of the accounts and supplementary data, it is found that: the buildings are valued at $200,000; land, $60,000; machinery, $140,000; tools, $21,000; office supplies, $1,000. The raw material inventory of $20,000 includes goods invoiced but not yet received, amounting to $1,000, for which no liability has been set up. In a report from the chief engineer, it is found that, among other items, $12,000 worth of prepared shingles had been charged directly to production, although of this total, $8,000 is still on hand and is not included in the inventory.

The company was offered by the local commercial association, and accepted on December 15, 1918, a piece of land to be used as additional plant site, valued at $20,000. The transaction has not yet been placed on the books, inasmuch as the land is regarded as a gift.

Of the accounts receivable, $10,000 represent goods out on consignment. Of the bills receivable, $20,000 consist of notes that have been pledged as a guaranty on contracts under way.

Included in the accounts payable of $89,123.47 is a bank loan for $10,000. It was also ascertained that one of the claims against transportation companies, totaling $1,200, has been lost.

The 20-year leasehold right appears on the books at the figure paid for it on January 1, 1916.

Included in sundry debtors is an item of $5,500, representing a loan made to the president.

MISCELLANEOUS QUESTIONS

Question 51--

(a) What are the two general classes of overhead expenses?

(b) To which one of these two general classes do the following accounts of a manufacturing company belong:

1. Purchasing department expenses
2. Bad debts written off
3. Directors' fees
4. Credit department expenses
5. Federal corporation tax
6. District office expenses
7. Fire and liability insurance
8. Storekeeping and receiving expenses
9. Wages paid factory employees while absent on account of illness
10. Auditing expenses
11. Defective work
12. Sample expense

Question 52--What entries are required to record the following:

(a) Equipment dismantled--estimated original cost, $9,047.50

(b) Proceeds from sale of scrap recovered, $783.47

Question 53--How would the following bookkeeping errors, if not adjusted, affect a balance sheet at the end of a fiscal year with the relative statement of profits:

(a) A charge of $3,101.73 to the plant and machinery in respect of repairs to certain equipment--the charge was made in July, 1918, and depreciation was written off at December 31, 1918, at the rate of 10% per annum on the ledger balances at the latter date.

(b) Overvaluation of $12,093.76 in the inventory of raw materials and supplies at the end of the year and an undervaluation of $9,371.22 in the inventory at the beginning of the year.

Question 54--How should the following items be dealt with, if at all, in the accounts of a company closing its books on December 31, 1918:

(a) Liabilities of $13,093.22 relating to the period prior to December 31, 1918, and not taken up on the books until January, 1919. The entire amount representing charges in respect of legal fees, stationery and printing, telegraph and telephone, and other current running expenses.

(b) The inventory at December 31, 1918, amounted to, at cost, $439,183.27, and at market, $398,111.14--taken up in the books at cost.

(c) Investments in other companies at cost $168,037.11; at market $197,093.27--taken up in the books at market.

Prepare the necessary journal entries in respect of the items that you think require adjustment. What is the effect on the balance sheet?

Question 55--How would you distribute the following expenditures in the case of a manufacturing concern:

(a) Charges totaling $1,491.14 in connection with the relining of copper boiling kettles. The kettles require to be relined at intervals of approximately six months. The original cost of the kettles was $40,000.

(b) The blacksmith shop was extended at a total cost of $13,804.93 in order to effect a saving in the cost of and to increase the production. In doing this work it was necessary to tear down the wall of the existing building at the point from which the building was extended. Do you consider that any cognizance need be taken of this loss in value arising from the tearing down of the wall? If so, why?

Solution to Problem 20

The general factory expenses consist of the following:

PARTICULARS	AMOUNT
Superintendent's Salary	$6,000.00
Foremen's Salaries	8,950.00
Factory Office Salaries	4,780.00
Telegraph and Telephone	308.92
Stationery and Printing	989.32
Or a TOTAL of	$21,028.24

Which should be distributed over the various departments as follows:

DEPARTMENT	PRODUCTIVE LABOR		DISTRIBUTION OF FACTORY EXPENSES	
	Amount	Per Cent to Total	Amount	Per Cent to Total
A	$ 93,107.32	31.82	$ 6,691.28	31.82
B	101,391.42	34.65	7,286.64	34.65
C	98,103.12	33.53	7,050.32	33.53
	$292,601.86	100.00	$21,028.24	100.00

SUMMARY OF DEPARTMENTAL FACTORY BURDEN OR OVERHEAD
AND PERCENTAGE TO THE PRODUCTIVE LABOR

PARTICULARS	DEPT. A	DEPT. B	DEPT. C	TOGETHER
Productive Labor	$93,107.32	$101,391.42	$98,103.12	$292,601.86
Departmental Factory Expenses:				
Wages of Unskilled Workmen	$20,013.11	$ 18,073.27	$14,091.34	$ 52,177.72
Light	1,078.27	1,303.05	1,811.32	4,192.64
Depreciation	3,989.23	4,809.32	8,073.11	16,871.66
Repairs and Renewals	4,098.28	9,081.78	10,108.33	23,288.39
Taxes	1,100.00	1,400.00	1,800.00	4,300.00
Oil and Waste	989.50	1,208.43	1,383.11	3,581.04
Power Expenses	2,138.17	3,289.42	3,033.11	8,460.70
General Factory Expense	6,691.28	7,286.64	7,050.32	21,028.24
Together	$40,097.84	$ 46,451.91	$47,350.64	$133,900.39
Per Cent to Productive Labor	43.07	45.81	48.27	45.76

Solution to Problem 21

Exhibit A

(a)

A B AND C--JOINT VENTURE IN
ROYAL AND ARCADIA OIL WELLS
STATEMENT OF PROFIT AND LOSS
YEAR ENDING DECEMBER 31, 1918

PARTICULARS	ROYAL	ARCADIA	TOGETHER
SALES	$96,500.00	$120,600.00	$217,100.00
LESS--COST OF SALES:			
Operating Expenses	$15,250.00	$ 11,600.00	$ 26,850.00
Manager's Salary	4,000.00	2,000.00	6,000.00
Proportion Leasehold Cost	2,635.42	1,715.00	4,350.42
Depreciation	479.17	455.00	934.17
Total Cost	$22,364.59	$ 15,770.00	$ 38,134.59
Less--Inventory, Dec. 31, 1918	1,500.00	4,400.00	5,900.00
Cost of Sales	$20,864.59	$ 11,370.00	$ 32,234.59
GROSS PROFIT FROM OPERATIONS	$75,635.41	$109,230.00	$184,865.41
LESS--INTEREST CHARGES AND CREDITS:			
Interest on Mortgage (A and B)	$ 2,460.00	$ 600.00	$ 3,060.00
Interest on Lease Payment (C)	1,260.00	1,380.00	2,640.00
Interest on Legal Fees (C)	62.50	65.00	127.50
Interest on Construction (C)	375.00	303.00	678.00
Interest on Expenses (C)	381.25	290.00	671.25
Total Interest Charges	$ 4,538.75	$ 2,638.00	$ 7,176.75
Interest on Cash from Sales (C)	750.00	880.00	1,630.00
Net Interest Charges	$ 3,788.75	$ 1,758.00	$ 5,546.75
NET PROFIT FROM OPERATION	$71,846.66	$107,472.00	$179,318.66

Exhibit B

(b)

A B AND C--JOINT VENTURE IN
ROYAL AND ARCADIA WELLS
BALANCE SHEET DECEMBER 31, 1918

ASSETS

	ROYAL	ARCADIA	TOGETHER
CURRENT ASSETS:			
Oil on hand	$ 1,500.00	$ 4,400.00	$ 5,900.00
Customers' Accounts	21,500.00	32,600.00	54,100.00
Total Current Assets	$23,000.00	$37,000.00	$ 60,000.00
LEASEHOLDS	$60,614.58	$32,585.00	$ 93,199.58
LAND IMPROVEMENTS AND CONSTRUCTION	$12,500.00	$10,100.00	$ 22,600.00
LESS--Reserve for Depreciation	479.17	455.00	934.17
Total Capital Assets	$12,020.83	$ 9,645.00	$ 21,665.83
Total All Assets	$95,635.41	$79,230.00	$174,865.41

LIABILITIES

ACCOUNTS CURRENT WITH PARTNERS:		
A	$107,232.89	
B	72,372.89	
	$179,605.78	
Less--Balance in C's account	4,740.37	$174,865.41

NOTES--

1. C's account current is deducted from the total of A's and B's in order to show the net balance invested in the business. Ordinarily the amount would be shown as a current asset.

2. Accounts current are opened with the partners inasmuch as their investments fluctuate according to the business done (there being no cash account) and are, moreover, of a temporary nature.

3. Separate books should be kept in a case like this, even though there is no cash account.

SUMMARY OF PARTNERS' ACCOUNTS CURRENT

	A	B	C
ADVANCES AND INTEREST:			
Payment on Leases acquired	$----------	$----------	$ 44,000.00
Interest--12 months	----------	----------	2,640.00
Mortgages assumed	41,000.00	10,000.00	----------
Interest--12 months	2,460.00	600.00	----------
Legal Fees paid	----------	----------	2,550.00
Interest--10 months	----------	----------	127.50
Land Improvements and Construction	----------	----------	22,600.00
Interest--6 months	----------	----------	678.00
Operating Expenses paid	----------	----------	26,850.00
Interest--5 months	----------	----------	671.25
Salary allowance	4,000.00	2,000.00	----------
Net Profits from Operation	59,772.89	59,772.89	59,772.88
Total Credits	$107,232.89	$72,372.89	$159,889.63
RECEIPTS FROM OPERATION:			
Cash from Sales	$----------	$----------	$163,000.00
Interest--2 months	----------	----------	1,630.00
	$----------	$----------	$164,630.00
Balance December 31	$107,232.89	$ 72,372.89	*$ 4,740.37

*Debit Balance.

(c)

ENTRIES TO RECORD SALE OF ROYAL WELLS

(1)

Cash	$250,000.00	
Reserve for Depreciation on Construction	479.17	
To--Leasehold		$ 60,614.58
Land Improvements and Construction		12,500.00
Inventory		1,500.00
Customers' Accounts		21,500.00
Profit and Loss		154,364.59
To record sale of Royal wells as per bill of sale dated.................		

(2)

Profit and Loss	154,364.59	
To--A--Account Current		51,454.87
B-- " "		51,454.86
C-- " "		51,454.86
Distribution of profit on sale of Royal wells.		

ANSWERS TO QUESTIONS

Answer to Question 41--

(a) The expenditures of $93,083.11 representing additional capital outlay would at once be admitted as a charge against the Property Account--provided an entry is made relieving the Property Account and per contra debiting Depreciation Reserve Account with the cost value of the machinery replaced.

(b) Conservatively, an expense, unless certain officers are devoting part of their time to superintending the new construction, in which case a proportion of their salaries may be regarded as a capital expenditure, is chargeable to Plant and Equipment.

(c) The amount may be charged to an appropriate capital asset account and a reserve created out of profits, crediting thereto each year 1/27 of the cost of the leasehold. A similar policy should be followed in case buildings or improvements are put on the land, inasmuch as they will be valueless at the expiration of the lease. Short-term leases frequently appear on the balance sheet as a deferred charge.

Answer to Question 42--

(a) From the description of the expenditure in the question it would appear that the entire amount of $4,391.27 should be charged against Repair and Maintenance Account--the expenditures being incurred in connection with repair work. It may be, however, that the work undertaken was more than in the nature of ordinary repairs and involved the replacement or renewal of some large parts of the power equipment. In this case an apportionment between operating expense and depreciation reserve would be necessary.

(b) If the remodeling expenditure of $4,131.11 did not have the effect of increasing the capacity of the boiler house or reducing the cost of operation, it would be a charge to operating expense or depreciation reserve. The apportionment would depend on the extent to which accrued depreciation had been made good in the course of the remodeling. Any increase in capacity incident to the remodeling would of course be chargeable to Property account.

The expenditure of $5,103.71 in connection with the extension is unquestionably of a capital nature and should be charged to the proper capital asset account.

Answer to Question 43--

(a) If the repair and renewal was "ordinary" it should be charged in its entirety to operating expense. But if part of this expenditure was "extraordinary" in that it made good a portion of the accrued depreciation of the machine shop equipment, thus prolonging its life, that part of the expenditure is properly chargeable to the depreciation reserve.

(b) The entire expenditure being in the nature of an addition or extension to the property would at once be admitted as a proper charge against the Capital Asset Account.

<u>Answer to Question 44</u>--

(a) Work in process has reference to contracts under way or uncompleted jobs which should be valued at the factory cost thereof.

(b) Direct or productive labor represents that part of labor engaged in the production of goods in contradistinction to the indirect or non-productive labor. In the case of a company using the job order system, productive or direct labor can be distributed over the various jobs or orders upon which the labor was expended.

(c) Overhead expenses represents the general factory expenses, general and administrative expenses, and selling expenses which cannot be specifically alloted to certain orders or jobs, being distributed on a more or less arbitrary basis.

The two general classes of overhead expenses are:

1. General factory expenses or factory overhead
   - Non-productive or indirect labor
   - Salaries of works manager, foremen, and other factory department heads
   - Taxes
   - Insurance (fire and liability)
   - Depreciation of buildings, machinery, and equipment
   - Repairs and renewals of buildings, machinery, and equipment
   - Power expenses
   - Storekeeping and receiving expenses
   - Other miscellaneous factory expenses

2. General and administrative and selling expenses or general and selling overhead:

   General and Administrative Expenses:
   - Management Salaries
   - Office Salaries
   - Telegraph and Telephone
   - Stationery and Printing
   - General Traveling Expenses
   - Depreciation on General Office Furniture and Fixtures
   - Corporation Tax
   - Other Miscellaneous Expenses

   Selling Expenses:
   - Salesmen's Salaries and Commissions
   - Salesmen's Traveling Expenses
   - District Office Expenses
   - Advertising
   - Other Miscellaneous Expenses

<u>Answer to Question 45</u>--If the factory burden, under normal conditions, is equivalent to 100% of the productive labor, the inventory has been fairly and conservatively valued. The difference between the actual factory burden or expenses applicable to the inventory at December 31, 1918, and the amount taken up in the inventory would be charged to the Profit and Loss Account of the period ended that date. The amount of the write-off might be sent out separately in the statement of profits and income as a deduction from the gross profits from operation and described as "excess of factory expenses over the normal burden or overhead."

Should it be that the actual factory expenses (equivalent to 120% of the productive labor) represent the expenses under normal conditions, the inventory valuation should be adjusted in respect of the difference between the amount of $98,111.32 (100% of productive labor) taken up in the accounts and the amount of $117,733.58 (120% of productive labor) that should have been taken up. It is assumed that the items making up the inventory of finished product are representative of the total manufactured product on which the 120% burden was incurred.

BALANCE SHEET CONSTRUCTION

The balance sheet has been previously defined as a list of the assets, liabilities, and net worth so arranged as to set out as clearly as possible the true financial condition of an individual, firm, or corporation at a particular moment of time.

In order to set out the <u>true</u> financial condition, the assets and liabilities must be correctly valued, and the audit procedure involved will be discussed in Lectures 16 to 30. In order to set out the financial condition <u>clearly</u> it is essential that the assets and liabilities be correctly labeled and properly arranged. As no single arrangement will cover all circumstances the purpose for which the statement is to be used should be first ascertained. The following are common:

1. Internal report, not extending beyond the management and directors
2. Report to stockholders, such as an annual report
3. Report to bankers with whom the business carries on its current financing
4. Report to governmental agencies including state and federal income tax collectors, state corporation commission, and state utilities commission, and Interstate Commerce Commission in the case of public utilities.

It is desirable to follow well-established precedents, provided the required information is set out. But it does not follow that a balance sheet should be simply an arrangement of the ledger accounts of a business. Sometimes it is desirable practically to disregard the ledger accounts. Most supervisory bodies such as those mentioned in (4) have a prescribed form that must be followed.

Variation in balance sheets according to purpose for which used is indicated in the following references:

For Credit Purposes:
Uniform Accounting: A Tentative Proposal Submitted by the Federal Reserve Board. (Reprinted from Federal Reserve Bulletin, April, 1917)

Taxation:
Schedule C--1918 Corporation Income and Profits Tax Returns (Form 1120)

Public Utility Regulation:
Interstate Commerce Commission Classification of Accounts for Electric Railways, 1914

Annual Reports:
United States Steel Corporation. Northern States Power Co., Hudson's Bay Co., Studebaker Corporation, Goodyear Tire and Rubber Co., American Smelting and Refining Company.

REFERENCES:
Kester, Vol. II, Chapters IV and V
Dickinson, Chapter II

COMPLETE ACCOUNTING COURSE--PART II

Lecture 12

STATEMENT OF APPLICATION OF FUNDS

Problem 27 (For class work)

From the following comparative balance sheets at December 31, 1917, and 1918, prepare a statement showing the change in the financial condition of the X Y Z Company between the two dates:

ASSETS	AS AT DECEMBER 31 1917	1918
Real Estate	$ 50,000.00	$ 75,000.00
Plant Equipment	350,000.00	425,000.00
Small Tools and Other Equipment	100,000.00	130,000.00
Inventories	510,000.00	615,000.00
Customers' Accounts	260,000.00	300,000.00
Notes Receivable	70,000.00	85,000.00
Accrued Interest on Notes Receivable	1,500.00	2,000.00
Consignment Stocks	90,000.00	100,000.00
Rent Paid in Advance	3,000.00	4,000.00
Insurance Premiums Prepaid	3,500.00	5,000.00
	$1,438,000.00	$1,741,000.00

LIABILITIES	1917	1918
Preferred Stock	$ 300,000.00	$ 350,000.00
Common Stock	250,000.00	300,000.00
First Mortgage 6% Bonds	400,000.00	500,000.00
Notes Payable	100,000.00	135,000.00
Accounts Payable	145,000.00	250,000.00
Accrued Interest	3,000.00	4,500.00
Accrued Wages	10,000.00	11,000.00
Accrued Taxes	2,000.00	4,000.00
Surplus Account	228,000.00	186,500.00
	$1,438,000.00	$1,741,000.00

Problem 28

The Chicago Machinery Manufacturing Company's transactions (manufacturing department) for the month of March are as follows:

1. The general stores department reports the issues for the month to be as follows:

Expended on

ORDER NO.	VALUE
138	$13,013.24
140	1,039.23
178	9,113.27
196	8,302.95
185	15,992.04
137	18,047.03

2. The foundry department reports the castings made during the month and the cost thereof to be as follows:

ORDER NO.	COST
137	$ 3,098.11
140	4,037.02
178	9,172.09
193	11,027.04
196	1,083.27
185	31,037.27
138	19,039.83

The credit in respect to these items should be carried to the Foundry Department Account.

3. The productive labor for the month amounted to $45,546.25 and was expended on the following orders:

ORDER NO.	AMOUNT
138	$ 9,037.31
140	11,049.02
178	3,073.27
196	7,325.33
185	13,071.32
137	1,990.00

4. The indirect factory expenses for the month amounted to $21,037.11 and should be distributed against the various orders in the proportion that the productive labor on each bears to the total amount of productive labor.

5. The following orders were completed during the month: 138, 140, 185, and 137, and shipment made of the finished product. Assume for the purposes of the problem that there was no work in progress at the beginning of the month.

6. The selling prices of the orders that were shipped were as follows:

ORDER NO.	SELLING PRICE
138	$50,000.00
140	20,000.00
185	60,000.00
137	40,000.00

Formulate all of the entries necessary in respect to the foregoing and prepare a statement showing the gross profit on each order.

Problem 29

From the following balance sheets prepare a statement showing the application of the funds during the year ending December 31, 1918:

ROCKWELL MANUFACTURING CO.
BALANCE SHEET, DECEMBER 31, 1917

ASSETS

CAPITAL ASSETS:		
Land	$100,000.00	
Buildings	190,000.00	
Machinery and Equipment	240,000.00	$ 530,000.00
CURRENT ASSETS:		
Inventories	$160,000.00	
Customers' Accounts and Notes Receivable (less reserves)	275,000.00	
Sundry Debtors	25,000.00	
Cash on Hand and in Bank	35,000.00	495,000.00
DEFERRED CHARGES TO INCOME		15,000.00
		$1,040,000.00

LIABILITIES

CAPITAL STOCK ISSUED AND OUTSTANDING		$ 500,000.00
FIRST MORTGAGE 6% BONDS		200,000.00
CURRENT LIABILITIES:		
Bank Loans	$225,000.00	
Other Liabilities	25,000.00	250,000.00
SURPLUS		90,000.00
		$1,040,000.00

BALANCE SHEET, DECEMBER 31, 1918

ASSETS

CAPITAL ASSETS:		
Land	$150,000.00	
Buildings	290,000.00	
Machinery and Equipment	385,000.00	$ 825,000.00
CURRENT ASSETS:		
Inventories	$231,000.00	
Customers' Accounts and Notes Receivable (less reserves)	264,000.00	
Sundry Receivables	28,000.00	
Cash on Hand and in Bank	32,000.00	555,000.00
DEFERRED CHARGES TO INCOME		20,000.00
		$1,400,000.00

LIABILITIES

CAPITAL STOCK ISSUED AND OUTSTANDING		$ 650,000.00
FIRST MORTGAGE 6% BONDS		300,000.00
CURRENT LIABILITIES:		
Bank Loans	$275,000.00	
Other Liabilities	40,000.00	315,000.00
SURPLUS		135,000.00
		$1,400,000.00

NOTE--The only debit against the Surplus Account is a $50,000 dividend declared and paid.

MISCELLANEOUS QUESTIONS

Question 56--Explain and illustrate how you would arrive at the book value of the capital stock of a corporation.

Question 57--Some companies consider that the following expenditures are proper charges to include as part of the cost of manufacture:

(a) Interest on borrowed money
(b) General and administrative expenses other than office expenses
(c) Rent

What is your opinion?

Question 58--A machinery manufacturing concern has constructed a new machine shop and equipped it with new machinery. A portion of the work has been done by

the company's own men and a portion by outside contractors. The extension has rendered it necessary to provide increased power, and consequently an old engine has been sold and been replaced by a larger one.

How would you undertake to satisfy yourself that the proper entries were made in respect of the foregoing?

<u>Question</u> <u>59</u>--How do you consider that the following items should be distributed in the accounts of a manufacturing concern?

(a) Payments totaling $83,150 on account of "Construction Work in Progress." This amount represents about 25% of the total amount to be paid under the respective contracts; furthermore, it is estimated that it will take from four to five months to complete the construction of the plant.

(b) Outstanding liabilities of $33,103.11 in respect of construction work completed prior to the close of the year. The liabilities referred to were not taken up in the books before closing at December 31, 1918.

<u>Question</u> <u>60</u>--The machinery account of a certain manufacturing company shows a debit of $100,000. One of the machines, originally charged to the account at $10,000, is sold for $9,000. The recorded depreciation reserve on the machine to the date of sale is $400.

Show the journal entries necessary to record the sale.

<u>Solution</u> <u>to</u> <u>Problem</u> <u>27</u>

X Y Z COMPANY
STATEMENT SHOWING CHANGE IN FINANCIAL CONDITION
DURING THE YEAR ENDING DECEMBER 31, 1918

FUNDS PROVIDED:		
Sale of Preferred Stock at par	$50,000.00	
Sale of Common Stock at par	$50,000.00	$100,000.00
First Mortgage 6% Bonds at par		100,000.00
OR A TOTAL OF		$200,000.00
WHICH WAS APPLIED IN THE FOLLOWING MANNER:		
Expenditures in the acquisition of additional properties:		
Land	$25,000.00	
Plant Equipment	75,000.00	
Small Tools, etc.	30,000.00	$130,000.00
Losses from Operation during year ending December 31, 1918		41,500.00
Net Increase in Working Capital as summarized below		28,500.00
(AS ABOVE)		$200,000.00

SUMMARY OF WORKING CAPITAL
AS AT DECEMBER 31

CURRENT ASSETS:	1917	1918	INCREASE	DECREASE
Inventories	$510,000.00	$ 615,000.00	$105,000.00	--------
Accounts Receivable	260,000.00	300,000.00	40,000.00	--------
Notes Receivable	70,000.00	85,000.00	15,000.00	--------
Accrued Interest thereon	1,500.00	2,000.00	500.00	--------
Consignment Stocks	90,000.00	100,000.00	10,000.00	--------
Rent Paid in Advance	3,000.00	4,000.00	1,000.00	--------
Insurance Premiums	3,500.00	5,000.00	1,500.00	--------
	$938,000.00	$1,111,000.00	$173,000.00	--------
CURRENT LIABILITIES:				
Notes Payable	$100,000.00	$ 135,000.00	$ 35,000.00	--------
Accounts Payable	145,000.00	250,000.00	105,000.00	--------
Accrued Taxes, etc.	15,000.00	19,500.00	4,500.00	--------
	$260,000.00	$ 404,500.00	$144,500.00	--------
Working Capital	$678,000.00	$ 706,500.00	$ 28,500.00	--------

Another form very commonly used in those cases where funds are provided from only one or two sources is given below.

The proceeds from the sale of preferred stock $50,000; common stock $50,000; and first mortgage 6% bonds $100,000--aggregating in all $200,000--were applied in the following manner:

1. Losses from operation during the year 1918		$ 41,500.00
2. Expenditures in the acquisition of additional properties:		
Land	$25,000.00	
Plant Equipment	75,000.00	
Small tools and other equipment	30,000.00	
Or a total of		130,000.00
3. Net increase in the working capital as summarized		28,500.00
(As above)		$200,000.00

Solution to Problem 23

(1)

Missouri Pacific First Mortgage Bonds	$ 90,000.00	
C. & N. W. Ry. Co. First Mortgage Bonds	125,000.00	
Loans to Sundry Persons	39,000.00	
Preferred Stock in the New Mfg. Co.	35,000.00	
Investment in the firm of C & D	34,000.00	
To--Estate Account		$300,000.00
Sundry Liabilities		23,000.00
To record C's NET assets, per inventory, at his death June 15, 1918.		

(2)

Estate Account	3,000.00	
To--Sundry Liabilities		3,000.00
To take up the additional liabilities disclosed subsequent to the date of inventory, June 15, 1919.		

(3)

Cash	329,500.00	
To--Missouri Pacific First Mortgage Bonds		94,000.00
C. & N. W. Ry. Co., First Mortgage Bonds		131,000.00
Loans to Sundry Persons		24,500.00
Preferred Stock in the New Mfg. Co.		40,000.00
Investment in the firm of C & D		40,000.00
To record the proceeds from the sale of assets.		

(4)

Missouri Pacific Ry. First Mortgage Bonds	4,000.00	
C. & N. W. Ry. Company First Mortgage Bonds	6,000.00	
Preferred Stock in the New Mfg. Company	5,000.00	
Investment in the firm of C & D	6,000.00	
To--Estate Account		21,000.00
To transfer profit on realization of assets.		

(5)

Estate Account	14,500.00	
To--Loans to Sundry Persons		14,500.00
To transfer loss on realization of assets.		

(6)

Sundry Liabilities	26,000.00	
To--Cash		26,000.00
To record payment of sundry liabilities.		

NOTE--Cash book entries presented in journal form for convenience.

Solution to Problem 24

(1)

Life Insurance Policy (face value)		$ 5,000.00	
Preferred Stock--Wilson Manufacturing Co.		100,000.00	
Dividend Receivable*--Wilson Manufacturing Co.		10,000.00	
Loan to John Smith		25,000.00	
First Mortgage 5% Bonds--Western Lumber Co.		291,000.00	
Interest Accrued:			
On Loan to John Smith	$ 750.00		
On First Mortgage 5% Bonds	4,850.00	5,600.00	
To--Sundry Liabilities			$ 8,000.00
Policy Loan			1,000.00
Accrued Interest on Policy Loan (July 1, 1915, to July 1, 1918)			150.00
Cash			1,350.00
Estate			426,100.00

To record assets and liabilities as appraised at July 1, 1918, as per inventory filed in probate court on ....

(2)

Cash	750.00	
To--Accrued Interest (John Smith Loan)		750.00

Interest due July 1, 1918, and presumably received.

(3)

Cash	10,000.00	
To--Dividend Receivable		10,000.00

To record receipt of dividend from Wilson Manufacturing Co. (Entry made on assumption that dividend was paid in cash.)

(4)

Policy Loan	1,000.00	
Accrued Interest on Policy Loan (Sept. 1, 1915, to July 1, 1918)	150.00	
Cash	3,845.83	
Interest Paid (July 1, 1918, to August 1, 1918)	4.17	
To--Life Insurance Policy		5,000.00

Policy paid less loan and accrued interest on loan from July 1, 1915, to August 1, 1918.

(5)

Funeral Expenses	900.00	
To--Cash		900.00

Payment of funeral expenses.

---

*In absence of more specific information it has been assumed that the dividend was declared prior to, but paid subsequent to, the date of A's death.

(6)

Cash	$ 7,275.00	
To--Accrued Interest on Western Lumber Co. First Mortgage 5% Bonds		$ 4,850.00
Interest Received		2,425.00
To record the receipt of the interest due September 1.		

(7)

Cash	301,212.50	
To--First Mortgage 5% Bonds		300,000.00
Interest Received		1,212.50
Proceeds from sale of Western Lumber Co. First Mortgage 5% Bonds plus accrued interest to October 1, 1918.		

(8)

First Mortgage Bonds	9,000.00	
To--Estate Account		9,000.00
To transfer profit on sale.		

(9)

Sundry Liabilities	8,000.00	
To--Cash		8,000.00
Liabilities paid.		

(10)

Interest Received	3,637.50	
To--Interest Paid		4.17
Income Account		3,633.33

(11)

Income Account	3,633.33	
To--Cash		3,633.33
Payment to widow of net income collected to December 31, 1919.		

(12)

Estate	900.00	
To--Funeral Expenses		900.00
To close latter account.		

SUMMARY OF CASH TRANSACTIONS

PARTICULARS	PRINCIPAL	INCOME	PARTICULARS	PRINCIPAL	INCOME
Interest--John Smith	$ 750.00		Balance	$ 1,350.00	
Dividends Receivable Wilson Mfg. Co.	10,000.00		Interest on Policy July 1 to Aug. 1, (contra)		$ 4.17
Life Ins. Policy	3,845.83		Funeral Expenses	900.00	
Interest on Policy July 1 to Aug. 1, (contra)	4.17		Sundry Liabilities	8,000.00	
Western Lumber Co.: First Mtge. 5% Bond Interest	4,850.00	$2,425.00	Widow		3,633.33
Western Lumber Co.: First Mtge. 5% Bonds Sold	300,000.00		Balance	309,200.00	
Accrued Interest		1,212.50			
	$319,450.00	$3,637.50		$319,450.00	$3,637.50

ANSWERS TO QUESTIONS

Answer to Question 46--An "Account Current" represents an account between two individuals, firms, companies, or offfices, which is "continuing," that is to say, a running account or an open account.

B & CO.
IN ACCOUNT WITH A & CO., DEBTOR
ACCOUNT CURRENT
FROM APRIL 1, 1919, TO AUGUST 31, 1919

DATE 1919	PARTICULARS		AMOUNT	DATE 1919	PARTICULARS		AMOUNT
April 1	Goods		$ 500.00	May 1	Cash		$ 220.00
July 1	Cash		830.00	June 16	Goods		1,250.00
July 15	Cash		750.00	Aug. 1	Goods		1,250.00
				Aug. 15	Goods		550.00
INTEREST ON ABOVE AMOUNTS:				INTEREST ON ABOVE AMOUNTS:			
	5 mo. @ 6% on $500	$12.50			4 mo. @ 6% on $ 220	$4.40	
	2 " " 6% " 830	8.30			2½ " " 6% " 1,250	15.62	
	1½ " " 6% " 750	5.62	26.42		1 " " 6% " 1,250	6.25	
Balance due from A & Co.			1,191.22		½ " " 6% " 550	1.37	27.64
			$3,297.64				$3,297.64

Answer to Question 47--In the preparation of a balance sheet it would be incorrect to state the net branch office account under the heading of Sundry Debtors, which is a term used to cover miscellaneous accounts due to the company. It must be remembered that a branch office is only a part of the organization and may cover capital assets, current assets, deferred charges, current liabilities, etc. Consequently, the net branch office account cannot be considered an account receivable because--

1. It is incorrect to offset liabilities against assets
2. It generally includes assets other than accounts receivable
3. If the net branch office account should happen to consist only of accounts receivable, in all probability they were created through the sale of product and consequently should be shown as Customers' Accounts Receivable instead of Sundry Debtors.

Answer to Question 48--

JOURNAL ENTRIES

(a)		
Cash	$76,500.00	
Fire Loss	12,450.00	
To--Buildings		$50,000.00
Fixtures		8,950.00
Merchandise Inventory		30,000.00
To record fire loss recovered from the Insurance Company, and loss sustained over and above insurance carried.		
(b)		
Real Estate	15,500.00	
To--Capital Surplus arising from revaluation of real estate		15,500.00
To record additional appraised valuation of land as per minutes of board of directors, p.		
(c)		
Real Estate	40,000.00	
Interest Paid in Advance	436.50	
To--Notes Payable		40,436.50
Notes given on purchase of real estate.		

Answer to Question 49--The form in which accounts are submitted to the probate court depends on whether the court has prescribed any particular form, and depends also on the character of the estate.

If no special form is required, the following statements may be submitted:

1. A comparative balance sheet as of the opening and close of the period, together with the increases and decreases.
2. Necessary supporting schedules.
3. Statements showing application of funds for the period.
4. Statement of income and expenditure for the period.
5. Statement of cash receipts and disbursements for the period.

Answer to Question 50--

(a) CAPITAL SURPLUS may be briefly defined as that part of the surplus which is not available for dividends in that it has not arisen from realized profits or in that it has been specifically set aside by the board of directors. In this class would appear--

1. Premium on capital stock
2. Writing-up of capital assets
3. Appropriation of earned surplus required by law or contract
4. Donations

(b) SURPLUS PROFITS available for dividends represent the profits for the period after all deductions have been made in respect of operating expenses, interest charges, appropriations from earnings for depreciation, sinking funds, etc. These profits are accumulated in a account called Surplus until the Directors declare dividends.

(c) ORGANIZATION OR PRELIMINARY EXPENSES are expenses incurred in connection with the organization of a corporation and consist of attorney's fees, incorporation fees, promotor's expenses, printing of prospectus, etc.

The best practice is to write off expenses of this nature within a comparatively short period, generally within three to five years.

STATEMENT OF APPLICATION OF FUNDS

Moody's Manual and other investment publications, whose purpose is to furnish financial data on industrial and other corporations, emphasize the importance of the comparative balance sheet. Much information may be furnished the prospective investor by explaining to him the changes that have taken place year by year in the financial policies of a corporation. To compare satisfactorily successive balance sheets requires a knowledge of what each balance sheet contains, and while it is to be hoped that the balance sheet of the future may become sufficiently standardized and self-explanatory, so that it may "speak for itself," it is apparent that the casual observer cannot make the proper analysis of a single balance sheet, or series of balance sheets, without recourse to considerable additional information.

Again, the management of a business may be unable to visualize the financial changes that have taken place during a given period. Or, during a period in which new capital, owned or borrowed, has been added to a business, the necessity may arise for a comprehensive summary which will more or less graphically set off the capital sums obtained against the new assets or working capital required.

The purpose of a statement of application of funds is to analyze the balance sheet changes between one date and another. Problem 27 and its solution, both appearing in this lecture, illustrate the preparation of such a statement. This case is a simple one. The funds provided during the fiscal period of most businesses will be limited to profits from operation and additions to reserves. Here there were losses, which means that more funds were expended in connection with material, labor and operating expenses than were realized from sales.

The following items are included among funds provided:

1. Cash realized from sales of securities issued.
2. Cash realized from sales of securities owned or other assets.
3. Profits from operation.
4. Additions to reserves excluded from (3), such as reserves for depreciation, obsolescence, insurance, etc.
5. Proportion of discounts on bonds and stock amortized. These and other similar items may be added back to (3)
6. Decreases in working capital

Applications of funds include:

1. Additions to capital assets
2. Losses from operation
3. Purchase of securities for investment
4. Extraordinary expenditures of various kinds not included elsewhere
5. Increases in working capital

The increase or decrease in working capital (the excess of current assets and prepaid expenses over current liabilities) usually appears as a single figure in this statement. Working capital is subject to a multitude of changes during any period of business operations, and while each item is important from the point of view of the balance sheet, the individual items lose their significance in a statement of application of funds since they are constantly in a state of change--raw materials, finished goods, customers' accounts, cash, raw materials--a steady cycle. Occasionally a marked variation in an item of working capital is shown separately. Thus, if an issue of securities is floated to pay off current bank loans, we would expect to find the latter separately listed among the funds applied.

Profits arising from "book profits," such as write-ups in asset valuations, stock dividends, etc., would be shown on the statement of application of funds as memoranda only. If the "net profit from operation" varies from the amount of profit shown elsewhere, it is desirable to set out the reconciliation as follows:

Net Profits as per Exhibit II		$30,475.24
Add--Loss from Sales of U. S. Steel Preferred held as investment	$1,520.00	
Proportion of Discount on Bonds written off	1,100.00	2,620.00
		$33,095.24

COMPLETE ACCOUNTING COURSE--PART II

Lecture 13

PROFIT AND LOSS CONSTRUCTION

Problem 30

Two professional firms, consisting of two partners each, agree to amalgamate. Jones and Robinson have accounts receivable, $12,500, and other assets taken as net, $1,250. Sikes and Wilson have accounts receivable, $11,000, and other assets net, $1,000, each firm bringing $2,500 in cash and discharging its own liabilities, with an arrangement that the partners of each firm shall have a preferential allowance of 15 per cent on professional fees arising from the connections of each firm.

At the end of twelve months ending December 31, 1918, the earnings were $49,500, of which $19,000 came from Jones and Robinson's introduction, $23,000 from Sikes and Wilson's, and the rest from neutral ground. The accounts receivable of Jones and Robinson were realized at an average loss of 6 per cent; those of Sikes and Wilson at 5 per cent. The expenses were $16,725.

As at the end of the year, make out the profit and loss statement of the amalgamated firm and the Capital Accounts of each partner, allowing interest on the net assets and cash brought in at 5 per cent per annum, but none on the accounts receivable. The drawings have been: Jones, $5,000; Robinson, $3,250; Sikes, $5,500; Wilson, $3,500--without interest.

Profits are divided as follows: Jones and Sikes, three-tenths each; Robinson and Wilson, two-tenths each. The same proportions govern the division of assets brought in and the preferential allowances.

Problem 31

From the following nominal accounts and supplementary data abstracted from the books of the A B Company at the close of business December 31, 1917, and December 31, 1918, prepare a comparative statement of profits and income and an analysis of causes of changes in profits earned:

ACCOUNT	DECEMBER 31, 1917	DECEMBER 31, 1918
Purchases	$46,000.00	$51,000.00
Interest Paid	1,213.00	1,660.00
Wages and Salaries	12,000.00	22,600.00
Salesmen's Salaries	4,100.00	5,600.00
Selling Expenses	1,800.00	2,000.00
Officers' Salaries	4,000.00	5,000.00
Office Expenses	2,236.42	1,550.00
Freight-in	896.12	1,200.00
Freight-out	324.00	460.00

Sales		$86,000.00		$107,000.00
Interest Received		700.00		1,100.00
Inventory at beginning	12,450.00		17,000.00	
Accrued Interest on:				
Bills Receivable		63.00		140.00
Bills Payable	73.50		126.00	
Inventory at end		17,000.00		18,000.00

MISCELLANEOUS QUESTIONS

Question 61--

(a) Differentiate between a sinking fund reserve and a depreciation reserve as to:

1. Purpose
2. Manner created
3. Ultimate disposition

(b) Under what circumstances could a sinking fund reserve be used in lieu of a depreciation reserve?

Question 62--Formulate entries in respect of the following:

(a) Annual provisions for sinking fund requirements for the five years ended December 31, 1918, $130,000
(b) Under the provisions of the trust deed, an equivalent amount was paid over to the trustees
(c) Increments to sinking fund represented in interest received, etc. $2,983.27
(d) Bonds, $100,000, redeemed through the operation of the sinking fund

Question 63--The New Manufacturing Company disposed of its entire first mortgage 6% bond issue of $500,000 at 90--the proceeds therefrom being used to meet the payment of obligations arising through the construction of a new plant.
Formulate the necessary entries to record the transaction and state how the discount item should be dealt with in the books.

Question 64--During the fiscal year ending December 31, 1918, the profits of the R Co. amounted to $12,000, which were not sufficient to justify the declaration and payment of a dividend. The directors propose that the depreciation provisions for that year be reduced in order that after deducting the proposed dividend the Profit and Loss account will still reflect a credit balance. What is your opinion of the proposed treatment?

Question 65--The B C Company indorsed certain notes given by another company in respect of bank loans made by that company. What cognizance, if any, would be taken of this fact in the balance sheet of the B C Company prepared as of December 31, 1918--the notes were outstanding at that date.

Solution to Problem 25

Exhibit II

A B MANUFACTURING COMPANY
STATEMENT OF PROFITS AND INCOME
MONTH ENDING JANUARY 31, 1918

GROSS SALES		$127,050.00
DEDUCT--Discount on Sales	$2,380.00	
Freight Allowances	6,180.00	8,560.00
NET PROCEEDS FROM SALES		118,490.00
COST OF SALES (Exhibit II-B)		73,924.63
GROSS PROFIT FROM OPERATION		44,565.37
DEDUCT--GENERAL AND ADMINISTRATIVE EXPENSES:		
Office and Management Salaries	$3,900.00	
Depreciation of Office Furniture and Fixtures	31.25	
General Expenses	1,800.00	5,731.25
NET PROFITS FROM OPERATION		38,834.12
DEDUCT--INTEREST ON BORROWED MONEY:		
On Notes Payable	$ 300.00	
On Bonded Indebtedness	1,500.00	1,800.00
SURPLUS NET PROFITS (carried to Surplus)		$ 37,034.12

Exhibit II-B

A B MANUFACTURING COMPANY
STATEMENT SHOWING COST OF PRODUCTION
MONTH ENDING JANUARY 31, 1918

(Production, 12,000,000 pounds)

		AMOUNT	PER POUND
RAW MATERIALS USED:			
Purchases Raw Material	$168,675.00		
LESS--Inventory January 31, 1918	47,580.00	$121,095.00	
LABOR		38,235.00	
FACTORY EXPENSES:			
Shop Expenses	$ 4,395.00		
Heat and Power	3,360.00		
Insurance	195.42		
Factory Office Supplies	735.00		
Shop Supplies	7,080.00		
Depreciation--Buildings	1,002.53		
Machinery	1,321.12	18,089.07	
COST OF PRODUCT MANUFACTURED		$177,419.07	$0.01478492

FINISHED PRODUCT STOCK ACCOUNT

DEBITS	POUNDS	PER POUND	AMOUNT
Inventory	----------	$----------	$----------
Product Produced	12,000,000	.01478492	177,419.07
	12,000,000	$ .01478492	$177,419.07
CREDITS			
Cost of Product Sold	5,000,000	$ .01478492	$ 73,924.63
Inventory	7,000,000	.01478492	103,494.44
	12,000,000	$ .01478492	$177,419.07

Exhibit I

A B MANUFACTURING COMPANY
BALANCE SHEET, JANUARY 31, 1918

ASSETS

CAPITAL ASSETS:			
Land			$ 67,200.00
Buildings		$481,215.00	
Machinery		211,380.00	
Office Furniture & Fixtures		3,750.00	
		$696,345.00	
DEDUCT--Depreciation Reserve		2,354.90	693,990.10
			$761,190.10
CURRENT ASSETS:			
Inventories of Finished Product		$103,494.44	
Raw Materials & Supplies		51,225.00	
		$154,719.44	
Customers' A/c $109,500 LESS--Reserves, Freight Allowances, & Discounts	7,225	102,275.00	
Cash		44,370.00	301,364.44
DEFERRED CHARGES:			
Prepaid Interest		$ 600.00	
Insurance Unexpired		6,839.58	7,439.58
			$1,069,994.12

LIABILITIES

CAPITAL STOCK:		
Authorized and Issued		$600,000.00
FIRST MORTGAGE 6% BONDS:		
Authorized and Issued		300,000.00
		$900,000.00
CURRENT LIABILITIES:		
Notes Payable	$60,000.00	
Accounts Payable	66,960.00	
Accrued Wages	4,500.00	
Accrued Bond Interest	1,500.00	132,960.00
SURPLUS ACCOUNT:		
Net Profit for the month of January, 1918, as per Statement of Profits and Income (Exhibit II)		37,034.12
		$1,069,994.12

JOURNAL ENTRIES

(1)

Raw Materials Used	$121,095.00	
To--Raw Materials Purchased		$121,095.00

Raw Materials consumed as per storekeeper's reports.

(2)

Labor	4,500.00	
To--Accrued Wages		4,500.00

To provide for the accrued wages at January 31, 1918.

(3)

Freight on Sales	5,475.00	
To--Reserve for Outstanding Freight Allowances		5,475.00

To provide for the estimated amount of the outstanding freight allowances at January 31, 1918 (5% of $109,500)

(4)

Discount and Allowances	1,750.00	
To--Reserve for Discounts		1,750.00

To provide for the estimated allowances on account of Sales Discounts.

(5)

Interest on First Mortgage 6% Bonds	1,500.00	
To--Accrued Bond Interest		1,500.00

To provide for the accrued interest for the month of January, 1918, on the First Mortgage 6% Bonds outstanding.

(6)

Depreciation on Buildings	1,002.53	
Depreciation on Machinery	1,321.12	
Depreciation on Furniture and Fixtures	31.25	
To--Reserve for Depreciation		2,354.90

Provision for month of January made up as follows:

	BOOK VALUES	ANNUAL RATE	DEPRECIATION JAN., 1918
Buildings	$481,215.00	2½%	$1,002.53
Machinery	211,380.00	7½%	1,321.12
Office Furn. and Fixt.	3,750.00	10 %	31.25
	$696,345.00		$2,354.90

(7)

Shop and Factory Office Supplies	$7,815.00	
To--Storekeeper's Account		$7,815.00
Issues of supplies during the month of January, 1918, as per storekeeper's distribution reports.		

(8)

Insurance	195.42	
To--Unearned Insurance Premiums		195.42
To write off the amount of the earned insurance premiums for the month of January, 1918.		

(9)

Prepaid Interest Account	600.00	
To--Interest on Notes Payable		600.00
Interest prepaid at January 31, 1918.		

Solution to Problem 26

THE CHICAGO COTTAGE CONSTRUCTION COMPANY
BALANCE SHEET, DECEMBER 31, 1918

ASSETS

CURRENT ASSETS:			
Cash and Cash Funds:			
Cash in Banks	$ 45,000.00		
Cash Deposit with Fiscal Agent	2,450.00		
Deposits on Bids	12,500.00	$ 59,950.00	
Accounts and Notes Receivable:			
Customers' Accounts	$220,000.00		
Less--Reserve for Bad Debts	13,000.00		
	$207,000.00		
Sundry Debtors	15,878.34		
Claims	2,592.00		
Due from Officers	5,500.00		
Bills Receivable (of which $20,000 are pledged as security on contracts under way)	60,100.00	291,070.34	
Temporary Investments:			
Illinois Co., Preferred Stock	$ 7,580.00		
Liberty Bonds	60,000.00	67,580.00	
Inventories:			
Completed Cottages	$ 15,000.00		
Merchandise in hands of Consignee	10,000.00		
Work in Progress	40,000.00		
Raw Materials	28,000.00		
Office Supplies	1,000.00	94,000.00	$ 512,600.34
DEFERRED CHARGES:			
Prepaid Insurance and Advertising		$ 1,050.00	
Prepaid Commissions		8,140.00	
Prepaid Interest		500.00	
Leasehold		850.00	10,540.00

INVESTMENT OF SINKING FUND			18,107.08
LAND, BUILDINGS, MACHINERY, ETC.:			
Land		$80,000.00	
Buildings	$200,000.00		
Machinery	140,000.00		
Tools	21,000.00		
Patterns, Molds, Drawings, etc.	30,000.00		
Furniture and Fixtures	4,700.00		
	$395,700.00		
Less--Reserve for Depreciation	55,250.00	340,450.00	
Houses for Employees		46,600.00	467,050.00
PATENTS, COPYRIGHTS, TRADE SECRETS AND GOOD-WILL			125,000.00
			$1,133,297.42

LIABILITIES

CURRENT LIABILITIES:			
Bills Payable		$100,000.00	
Accounts Payable		80,123.47	
Bank Loan		10,000.00	
Dividends Payable		10,000.00	
Accrued Taxes		976.00	$ 201,099.47
FIRST MORTGAGE 20-YEAR 6% BONDS			200,000.00
RESERVES:			
Reserve for Fire Losses		$ 25,000.00	
Reserve for Pending Lawsuits		20,000.00	45,000.00
NET WORTH:			
Preferred Stock Authorized and Issued	$200,000.00		
Less--Treasury Stock	30,000.00	$170,000.00	
Common Stock, Authorized	$200,000.00		
Less--Unissued	10,000.00	190,000.00	
Sinking Fund Reserve on First Mortgage Bonds		18,107.08	
Capital Surplus		20,000.00	
Surplus		289,090.87	687,197.95
			$1,133,297.42

ADJUSTING JOURNAL ENTRIES

(1)

Surplus	$ 1,000.00	
To--Accounts Payable		$ 1,000.00
To set up liability on account goods invoiced but not yet received, being included in raw material inventory.		

(2)

Raw Material	8,000.00	
To--Surplus		8,000.00
To set up inventory of prepared shingles improperly charged to production.		

(3)

Land	20,000.00	
To--Capital Surplus arising from donated land		20,000.00
To record plant site donated.		

(4)

Merchandise in hands of Consignee	10,000.00	
To--Accounts Receivable		10,000.00
To correct improper charge to Accounts Receivable for merchandise out on consignment.		

(5)

Bills Receivable Pledged	20,000.00	
To--Bills Receivable		20,000.00
Notes transferred as guaranty on contracts under way.		

(6)

Accounts Payable	10,000.00	
To--Bank Loan		10,000.00
To separate bank loan from trade creditors.		

(7)

Surplus	1,200.00	
To--Claims Against Transportation Companies		1,200.00
Claim lost.		

(8)

Surplus	150.00	
To--Leasehold		150.00
To write down leasehold to present value.		

ANSWERS TO QUESTIONS

Answer to Question 51--

(a) The two general classes of overhead expenses are:

1. General factory expenses, or factory overhead
2. General and administrative and selling expenses, or general and selling overhead

(b) Classification of items:

1. General factory expenses, or factory overhead:
   1. Purchasing department expenses
   7. Fire and liability insurance
   8. Storekeeping and receiving expenses
   9. Wages paid factory employees while absent on account of illness
   11. Defective work

2. General and administrative and selling, or general and selling overhead.
   2. Bad Debts written off
   3. Directors' fees
   4. Credit department expenses
   5. Federal corporation tax (this may also be considered as a distribution of profits)
   6. District office expenses
   10. Auditing expenses
   12. Sample expense

Answer to Question 52--

Cash	$ 783.47	
Depreciation Reserve	8,264.03	
To--Equipment		$9,047.50

To credit Equipment account with estimated original cost of equipment dismantled.

Answer to Question 53--

(a) The erroneous charge of $3,101.73 to the Plant and Machinery Account in respect of repairs to certain equipment has the effect of overstating the profits by $2,791.56, as 10% of the amount of $3,101.73 had already been written off as depreciation. The effect on the balance sheet is to overstate the capital assets $3,101.73, the reserve for depreciation $310.17, and the Surplus Account the difference between these two amounts, or $2,791.56. The adjusting entries to be made as of December 31, 1918, in order to correct this erroneous distribution, are as follows:

(1)

Repairs and Maintenance	$3,101.73	
To--Property Account		$3,101.73

(2)

Reserve for Depreciation	310.17	
To--Depreciation (Profit and Loss Account)		310.17

(b) The overvaluation of the inventory at the close of the year by $12,093.76 would have the effect of overstating the inventory value shown by the balance sheet in case the cost is less than the market price. It would also result in a corresponding overstatement of the Surplus account. The undervaluation of the inventory at the commencement of the period by $9,371.22 resulted in an understatement of the balance in the Surplus account carried forward from the prior year.

The current Profit and Loss account for the year would be affected by sum of both errors or a total overstatement of $21,464.98.

The following journal entries are required to make the necessary adjustments:

(1)

Profit and Loss Account this year	$12,093.76	
To--Inventory at close of this year		$12,093.76
To write off overvaluation of inventory at close of year.		

(2)

Profit and Loss this year	9,371.22	
To--Profit and Loss last year		9,371.22
Adjustment on account of undervaluation of inventory at beginning of year.		

Answer to Question 54--

(a) The liabilities aggregating $13,093.22 represent expenses that were clearly incurred in and applicable to the period prior to December 31, 1918, and therefore a charge against the Profit and Loss Account of that period. An entry should be made charging the various profit and loss accounts and crediting outstanding liabilities, the entry to be reversed as of the first of the succeeding month. All income and expenditure relating to a given period should be taken up so far as possible in that period.

(b) The accounting principle is to anticipate no profits and provide for all possible losses. In this case, the market values are considerably below the cost prices and the probability is that a substantial loss will be sustained in the realization of the stocks. In view of these circumstances it seems necessary that a reserve be created by a charge to the Profit and Loss Account in order to reduce the inventory to the market values prevailing on or about December 31, 1918.

(c) Generally speaking, the same principle that applies to inventory valuations applies to the valuation of securities held as marketable investments. A reserve of $29,056.16 should be created in this case to provide for the possible loss on the sale of the stocks. In this connection it might be well to quote from Mr. Dickinson's paper, "Profits of a Corporation," dealing with the valuation of investments in other companies held as marketable investments:

"The term Marketable Investments is intended to include only such investments as are part of the circulating as distinct from the fixed assets. The

latter class of investments may be defined as those which cannot be disposed of without affecting the operations, for the reason that the ownership thereof in a permanent form is necessary, however remotely, to the business which the corporation is carrying on. Their valuation would be governed by the same principles as have been outlined above for other fixed assets.

"Marketable investments, on the other hand, may be either:

(a) The stock in trade of the corporation,

(b) The investment of surplus cash held in this form until required for ordinary operating purposes, or

(c) The investment of a reserve or other special fund.

"In case (a) the rule of cost or market value, whichever is the lower, applied to each individual investment and not to the group as a whole, is undoubtedly the most conservative. That is to say, no profit could be taken up on any investment until it is sold, but on the other hand, where the value has clearly fallen, some provision should be made therefor. Where, however, the investments all have a definitely ascertainable market value at any time, it is perhaps fair and reasonable to allow a fall in value of some individual investments to be set off against a rise in value of others, provided that the aggregate valuation is not above original cost or market value, whichever is the lower.

"In case (b) the usual custom is to value at the mean market price on the last day of the fiscal period for the reason that the investments represent the equivalent of cash and should therefore be maintained at their cash value in the balance sheet.

"In case (c) any profit or loss, either realized or estimated, would be a credit or charge to that fund, and not to the Profit and Loss Account. But in the balance sheet such investments should either be clearly stated as maintained at cost or preferably be adjusted each year to the aggregate market value if below cost.

"Another method of dealing with the fluctuations of marketable investments of classes (b) and (c) is to create an investment fluctuation reserve, either out of estimated or realized profits on investments, or by a charge to Profit and Loss of such an amount as may be necessary to prevent this reserve from showing a debit balance, and by charges or credits to this reserve to maintain the Asset at market value."

Answer to Question 55--

(a) The relining expenditures of $1,491.14 represent ordinary repair and renewal work and as such would be a proper charge against the Profit and Loss Account. The necessity for the relining of the kettles, as explained in the question, arises every six months; therefore the effect of the expenditure is simply to maintain the kettles in a useful state without prolonging the life for any considerable length of time. Where monthly cost statements are desired it would be essential to set up a reserve for relining kettles by charging to each month's operations an estimated amount which it is believed will be sufficient for this purpose. Relinings when made would be charged to the reserve and the unexpended portion would be constantly carried forward.

(b) Inasmuch as the effect of the extension is "to effect a saving in the cost of and to increase the production" the cost thereof may be charged to the

capital account. But the wall torn down represents dismantled property and therefore should be deducted from the capital account and charged to the depreciation reserve at its original cost. The expenditure involved in dismantling the wall is also chargeable to the depreciation reserve. Where the amount involved is small it is oftentimes charged direct to operating expense.

CONSTRUCTION OF STATEMENT OF PROFIT AND LOSS

A statement of profit and loss accompanying a balance sheet is referred to as a "relative" statement, but this expression gives only an inkling of the real connection between the two. Since a relative statement of profit and loss covers the period immediately preceding the date of the balance sheet it is apparent that any changes in the valuation of balance sheet items will be reflected in the charges or credits to the Profit and Loss Account.

RELATION TO SURPLUS ACCOUNT--Frequently it will be found that losses have been incurred during the year applying to preceding periods, such as inventory losses, additional federal taxes and other expenses not ascertainable at the time the previous balance sheet was prepared. These items as incurred will be charged to surplus (or, better, to a profit and loss adjustment account for the previous period), unless very small in amount, in which case they are commonly included among current expenses. Any such changes in surplus may be made the subject of a separate statement in preparing the exhibits or may be added directly to the statement of profit and loss unless the latter thereby becomes too unwieldy.

The difference in the Surplus accounts on successive balance sheets should therefore be clearly accounted for in the exhibits.

POINTS INVOLVED IN CONSTRUCTING THE STATEMENT--It seems desirable at this point to review some of the principles of construction applying to profit and loss statements which should be borne in mind in their preparation:

1. GENERAL--Simplicity of arrangement, brevity, and clarity are the outstanding requirements of a good profit and loss statement. The report form is preferable to the account form. Supplementary or supporting exhibits, covering such details as gross profits by departments, cost of sales, and selling and general expenses, may be introduced should the more detailed analysis be warranted. The nomenclature of the various items should leave no doubt as to the significance thereof, explanatory remarks being inserted either directly after the item or in the form of a footnote. The point never to be lost sight of is that a profit and loss statement is prepared for the purpose of conveying information and that it is the duty of the accountant to present this information in the best possible manner.

2. SALES--An analysis of sales is of prime importance, inasmuch as it is desirable to analyze increases and decreases and unprofitable departments. A sales analysis may signify an analysis by months, by articles or departments, by districts in which sales are made, etc. Any of these analyses or a combination of two or more of them may be utilized for an exhibit accompanying a statement

of profit and loss. In an audit report the analyses may appear in the text of the report, or graphic methods may be resorted to (see Montgomery, page 277).

3. COST OF SALES--A cost of sales analysis may be prepared along the same lines as a sales analysis and included therewith in a single exhibit. In addition, where there are manufacturing operations, a separate exhibit should be prepared showing materials used, direct labor, and factory expenses in detail, preferably arranged in comparative form with the same items of the next preceding period or periods.

4. MISCELLANEOUS INCOME--Most businesses have small amounts of miscellaneous income each year which should not be included in sales. Sales of equipment or other property exceeding the cost thereof less depreciation, sales of scrap not essentially a by-product, income from investments, income from departments not operated primarily for profit, and other similar items will be found under this heading. Usually supporting exhibits are unnecessary.

5. SELLING AND GENERAL EXPENSES--The details of these expenses are usually set forth in separate exhibits arranged in comparative form.

6. INTEREST--Interest received from customers' notes and temporary investments may be considered as a miscellaneous income, or as a financial rather than operating earning. The same applies to interest paid.

REFERENCES:

Dickinson, Chapter III
Kester, Chapters XXII, XXVI, and XXVII
Hatfield, Chapters XI and XII

COMPLETE ACCOUNTING COURSE--PART II

Lecture 14

FOREIGN EXCHANGE

Problem 32

A and B, with a head office in Chicago, open a branch in London, England. The branch obtains its goods from the head office, and elsewhere, on personal, consignment, and joint account. Whenever funds warrant it, drafts (free) are drawn for shipments. A record of assets and liabilities is kept on the branch books, and all bills, expenses, etc., incurred by the branch, are paid directly by the branch. The Profit and Loss account is closed every six months, and monthly reports are sent to the head office.

SUMMARY OF TRANSACTIONS

1. A and B invested $480,000 in the branch house, which A remitted to London at the rate of 4.80 exchange.
2. B, in London, purchased office equipment, etc., amounting to £5,000.0.0.
3. A shipped goods on consignment amounting to $240,000, drawing a free draft for £25,000.0.0, receiving 4.80 exchange.
4. B purchased £40,000.0.0 worth of goods on credit from Brown Brothers, London, and sold one-half of the purchase on account for £25,000.0.0.
5. B established a petty cash fund, £1,000.0.0.
6. A shipped goods to B on personal account, valued at $47,500, drawing a draft for the full amount @ 4.75.
7. A shipped goods to B, valued at $47,600, drawing for £10,000.0.0 against the shipment @ 4.76.
8. B sold one-half of the shipment in (3) for £30,000.0.0 cash, and after deducting 3% commission and £100 expenses, remitted the balance at 4.75.
9. A decided to withdraw $380,000 of the amount originally advanced, and B remitted at 4.75 exchange.
10. A transferred to Investment account that portion represented in permanent expenditure, £5,000.0.0 @ 4.80.

From the above information prepare:

(a) Journal entries necessary to record the transactions on the books of both the branch and home office.

(b) Statements of the control accounts on the books of both the branch and home office, showing the balance due the branch office in terms of domestic (U. S.) currency, the current rate of exchange at the time of preparing these statements being 4.75.

Problem 33

The following statements were prepared from the books of the home and branch offices respectively and show the inter-office transactions taken up on the books of both offices:

PREPARED FROM BRANCH OFFICE BOOKS
STATEMENT OF HEAD OFFICE, CURRENT ACCOUNT

DEBITS		CREDITS	
Payment to the American Steel Works on account of charges for steel purchased by the home office	$ 4,000.00	Balance as per last statement rendered	$10,931.78
Telegraph and other charges during the period chargeable to the home office	304.77	Balance of Profit and Loss Account for the year	11,047.93
Balance at end of period	18,808.05	Taxes and other expenses paid by the home office	1,133.11
	$23,112.82		$23,112.82

PREPARED FROM HOME OFFICE BOOKS
STATEMENT OF BRANCH OFFICE, CURRENT ACCOUNT

DEBITS		CREDITS	
Balance as per last statement rendered	$10,931.78	Balance at end of period	$19,618.30
Taxes and other expenses paid on account of branch office	1,133.11		
Merchandise shipped to the branch office	2,103.41		
Cash	5,000.00		
Advances to the branch manager on account of traveling expenses	450.00		
	$19,618.30		$19,618.30

Prepare a statement showing a reconciliation of the two inter-office accounts. Also journal entries to adjust head office and branch office books.

MISCELLANEOUS QUESTIONS

Question 66--Explain the method of reconciling the control account on the home office books with the control account on the foreign branch office books.

Question 67--What rate of exchange would you use in converting the following items into American currency for the purpose of consolidating the figures with the New York head office statement?

LONDON TRIAL BALANCE

New York office		£100,000
Remittances	£ 50,000	
Cash	5,000	
Customers' Accounts	75,000	
Inventory at beginning	25,000	
Furniture and Fixtures	1,000	
Creditors' Accounts		31,000
Sales		150,000
Purchases	95,000	
Expenses	30,000	
	£281,000	£281,000

Question 68--Formulate entries in respect of the following:

(a) Preferred stock of $1,000,000 taken up by issue of first mortgage 6% bonds of same value, per resolution adopted by stockholders

(b) Preferred stock of $100,000 retired at 105, in accordance with the terms and conditions under which the stock was sold in the first instance

Question 69--Prepare the necessary journal and cash book entries in respect of the following transactions:

(a) Sale of $350,000 of preferred stock of the R Mfg. Co. at 115, with the proviso that no part of the premium is available for dividends

(b) Retirement on July 1, 1919, of $300,000 first mortgage 6% bonds maturing on July 1, 1920, at 102-1/2 in accordance with the terms and conditions of the trust deed covering the property securing the bonds

Question 70--How should the following be dealt with in a balance sheet prepared as of December 31?

(a) First mortgage 6% bonds, $200,000, put up as collateral for bank loans of $150,000

(b) Of total accounts receivable of $198,093.11, $125,000 are in dispute

Solution to Problem 28

(1)

Work in Progress Controlling Account		$65,507.76	
ORDER NO.	AMOUNT		
138	$13,013.24		
140	1,039.23		
178	9,113.27		
196	8,302.95		
185	15,992.04		
137	18,047.03		
To--General Stores Department			$65,507.76

Materials consumed during the month of March as per report of general stores department.

(2)

Work in Progress Controlling Account		78,494.63	
ORDER NO.	AMOUNT		
137	$ 3,098.11		
140	4,037.02		
178	9,172.09		
193	11,027.04		
196	1,083.27		
185	31,037.27		
138	19,039.83		
To--Foundry Department			78,494.63

Castings made during the month of March as per report of foundry department.

(3)

Work in Progress Controlling Account		45,546.25	
ORDER NO.	AMOUNT		
138	$ 9,037.31		
140	11,049.02		
178	3,073.27		
196	7,325.33		
185	13,071.32		
137	1,990.00		
To--Pay-Roll or Wages Account			45,546.25

Productive labor for month of March.

(4)

Work in Progress Controlling Account		$ 21,037.11	
ORDER NO.	AMOUNT		
138	$4,174.19		
140	5,103.37		
178	1,419.50		
196	3,383.46		
185	6,037.44		
137	919.15		
To--Indirect Factory Expenses			$ 21,037.11

Distribution of factory expenses for month over orders on ratio which the productive labor charged to each order bears to the total productive labor.

(5)

Finished Products, Controlling Account	156,685.57	
To--Work in Progress Controlling Account		156,685.57

Orders completed during month of March.

(6)

Cost of Goods Sold	156,685.57	
To--Finished Products Controlling Account		156,685.57

Entry in respect of cost values of the following orders shipped during the month of March:

ORDER NO.	MATERIALS	CASTINGS	PRODUCTIVE LABOR	INDIRECT. EXPENSES	TOTAL
137	$18,047.03	$ 3,098.11	$ 1,990.00	$ 919.15	$ 24,054.29
138	13,013.24	19,039.83	9,037.31	4,174.19	45,264.57
140	1,039.23	4,037.02	11,049.02	5,103.37	21,228.64
185	15,992.04	31,037.27	13,071.32	6,037.44	66,138.07
	$48,091.54	$57,212.23	$35,147.65	$16,234.15	$156,685.57

(7)

Customers' Accounts	$170,000.00	
To--Sales		$170,000.00

To record the shipment of the following orders:

ORDER NO.	SELLING PRICE
137	$ 40,000.00
138	50,000.00
140	20,000.00
185	60,000.00
	$170,000.00

CHICAGO MACHINERY MANUFACTURING CO.
SUMMARY OF ORDERS IN PROCESS
AT MARCH 31, 19--

ORDER NO.	MATERIALS	CASTINGS	PRODUCTIVE LABOR	INDIRECT EXPENSES	TOTAL
178	$ 9,113.27	$ 9,172.09	$ 3,073.27	$1,419.50	$22,778.13
196	8,302.95	1,083.27	7,325.33	3,383.46	20,095.01
193	--------	11,027.04	--------	--------	11,027.04
	$17,416.22	$21,282.40	$10,398.60	$4,802.96	$53,900.18

CHICAGO MACHINERY MANUFACTURING CO.
GROSS PROFIT ON ORDERS SHIPPED
DURING THE MONTH OF MARCH, 19--

	NO. 137	NO. 138	NO. 140	NO. 185	TOTAL
SALES	$40,000.00	$50,000.00	$20,000.00	$60,000.00	$170,000.00
COST OF SALES:					
Castings	$ 3,098.11	$19,039.83	$ 4,037.02	$31,037.27	$ 57,212.23
Stores Used	18,047.03	13,013.24	1,039.23	15,992.04	48,091.54
	$21,145.14	$32,053.07	$ 5,076.25	$47,029.31	$105,303.77
Productive Labor	1,990.00	9,037.31	11,049.02	13,071.32	35,147.65
Factory Expenses	919.15	4,174.19	5,103.37	6,037.44	16,234.15
Total	$24,054.29	$45,264.57	$21,228.64	$66,138.07	$156,685.57
GROSS PROFIT	$15,945.71	$ 4,735.43	$ 1,228.64*	$ 6,138.07*	$ 13,314.43

* Red to indicate loss.

Solution to Problem 29

ROCKWELL MANUFACTURING CO.
STATEMENT SHOWING APPLICATION OF FUNDS PROVIDED
DURING YEAR ENDING DECEMBER 31, 1918

FUNDS PROVIDED:		
Proceeds from the sale of:		
Capital Stock	$150,000.00	
First Mortgage 6% Bonds	100,000.00	$250,000.00
Net Profits, as per Statement of Profits and Income		95,000.00
OR A TOTAL OF		$345,000.00
WHICH WERE APPLIED IN THE FOLLOWING MANNER:		
Expenditures for:		
Land	$ 50,000.00	
Buildings	100,000.00	
Machinery and Equipment	145,000.00	$295,000.00
Dividends declared and paid		50,000.00
(As above)		$345,000.00

NOTE--There was no increase in the working capital of the company during the year. However, the following comparative table will be of interest:

	DECEMBER 31			
ASSETS	1917	1918	INCREASE	DECREASE
Inventories	$160,000.00	$231,000.00	$71,000.00	$---------
Customers' Accounts and Notes Receivable	275,000.00	264,000.00	---------	11,000.00
Sundry Debtors	25,000.00	28,000.00	3,000.00	---------
Cash on Hand and in Bank	35,000.00	32,000.00	---------	3,000.00
	$495,000.00	$555,000.00	$74,000.00	$14,000.00
Deduct--Current Liabilities	250,000.00	315,000.00	---------	65,000.00
Net Working Capital	$245,000.00	$240,000.00	$74,000.00	$79,000.00
Deferred Charges	15,000.00	20,000.00	5,000.00	---------
Total Working Capital and Deferred Charges	$260,000.00	$260,000.00	$79,000.00	$79,000.00

ANSWERS TO QUESTIONS

Answer to Question 56--The book value of a share of capital stock is the amount which the holder will be entitled to receive as of a certain date in case all assets are realized at their book values.

In the case of preferred stock the book value is the par value plus dividends in arrears, if any.

In the case of common stock the book value consists of the common stock, surplus and surplus reserves, less preferred stock dividends in arrears, if any.

The figures may be obtained from the balance sheet. Thus, in the solution of Problem 26, Lecture 11, we may ascertain the book value of common stock as follows:

Common Stock issued and outstanding	$190,000.00
Surplus	289,090.87
Capital Surplus	20,000.00
Sinking Fund Reserve	18,107.08
	$517,197.95

which, divided by 1,900 (the shares outstanding), gives a book value of $272.21 per share.

Answer to Question 57--

(a) Interest on borrowed money is not a proper item to include as part of the cost to manufacture, because interest is one form of profit. The effect of including such interest in the cost of manufacture is to include part of the profits in costs, and consequently in inventories to the extent that goods remain on hand.

(b) General administrative expenses are not proper expenditures to be included in manufacturing cost. It is oftentimes difficult to classify charges as between factory overhead and general overhead. But if the expenditure is classed as a general overhead it should be excluded from cost of production.

(c) At present there is considerable difference of opinion as to the propriety of including rent and the allied item of interest on the investment in factory facilities as part of production cost. This subject is treated in detail in cost accounting. However, from the auditor's point of view, it is generally held that these items must be excluded in determining the inventory valuation for balance sheet purposes, and in arriving at the surplus net profits for the fiscal period.

Answer to Question 58--

(a) Work done by outside contractors should be charged to property at the contract prices. Examine the contract and engineer's estimate of cost.

(b) Work done by company should be charged to property on a factory cost basis. Examine the storeroom slips showing the purpose for which materials were issued. Examine time cards as to time spent on the construction. Note the method followed in apportioning burden to the job.

(c) Ascertain cost value of old engine and credit same to Property Account. Charge Scrap with its estimated realizable value and the balance to Depreciation Reserve. The new engine should be charged to Property at cost. Cost in this case would be represented by the invoice price of the engine, freight and cartage to the plant, and the expense of installing and testing.

Answer to Question 59--

(a) The payments of $83,150 should be charged, pending the completion of the work, to a "Construction Work in Progress" account. All liabilities in respect of completed and accepted construction work should be taken up in the books as and when they accrue. As soon as the construction work is completed an entry should be made crediting the Construction Work in Progress Account and debiting the various detailed property accounts. The expenditures up to the date of the balance sheet should be classified under the general heading of Property Assets along with all other assets coming under that classification. It might also be mentioned that materials purchased and on hand to be used solely for construction purposes should be classified in the balance sheet as part of the property assets.

(b) Outstanding liabilities, $33,103.11. Liabilities incurred in respect of construction work completed and accepted prior to December 31, 1918, are outstanding obligations at that date and must be taken into consideration in arriving at the financial position of the company. The failure to provide for the same has the effect of understating the fixed or property assets and likewise the current liabilities.

Answer to Question 60--

Cash	$9,000.00	
Reserve for Depreciation	400.00	
Profit and Loss	600.00	
To--Machinery		$10,000.00
To record sale of machine and the loss resulting therefrom.		

FOREIGN EXCHANGE

GENERAL NATURE OF THE PROBLEM--Foreign exchange is a system whereby commercial nations discharge their debts to one another. Indebtedness may represent:

1. Value of commodities exported to or imported from other countries
2. Money borrowed, loaned, or invested abroad
3. Interest or profits on money borrowed, loaned, or invested abroad
4. Cost of transportation of goods and commission for service
5. Expense incurred in traveling in foreign countries
6. Any transaction which involves the exchange of money between countries

These debts must be paid in cash or something equally satisfactory to the creditors. Because of the cost and risk of transmitting gold or currency the system of exchanging debts through the medium of commercial paper has been developed.

SIGNIFICANCE OF GOLD--Gold, by virtue of its commercial usage and the laws of the various countries of the world, may be said to be the only international money whose purchasing power is practically the same throughout the civilized world. Gold is the only commodity the value of which is permanently established by law. Its price cannot be affected by either an abundance or scarcity of the supply. The price of diamonds--more valuable than gold--is affected by the law of supply and demand. Silver, the monetary standard in some countries, fluctuates in value in the same manner as any other commodity.

PAR OF EXCHANGE--The "mint par of exchange" between two countries may be obtained by dividing the weight of the pure gold in the gold unit of one country by the weight of the pure gold in the gold unit of the other country. The mint par of exchange between two gold standard countries does not vary; but as between countries where one or both have a silver or part silver standard there is a constant fluctuation. For example, the mint par of exchange between the United States and Great Britain is $4.86656, and is arrived at as follows: A gold dollar (U.S. unit) weighs 25.8 troy grains and is 9/10 fine, 1/10 consisting of an alloy which increases its durability. The pure gold content is therefore 23.22 troy grains. A British sovereign contains 123.274478 troy grains, 11/12 fine, or 113.001603 troy grains of pure gold. Dividing 113.001603 by 23.22 gives $4.86656--the worth of the sovereign in our money.

The "commercial par of exchange" is the mint par plus the transportation cost of its gold equivalent. In the case of the sovereign this might be about 4.88.

RATE OF EXCHANGE--The rate which bankers and exporters quote on foreign remittances is called the rate of exchange. The rate of exchange between any two countries is for drafts, checks, or bills of exchange; and the price includes, beside the actual equivalent of the standard coin, some allowance for interest, according to the terms of the drafts, and a premium which the seller demands for the economy and superior convenience of his draft or check as compared with a remittance in currency or bullion. This premium varies more or less according to the amount of exchange. Discount rates at London, Paris, and other centers are the rates at which commercial paper of the different classes may be discounted, i.e., before maturity.

ACCOUNTING PROBLEM OF FOREIGN EXCHANGE--The accounting problem involved in foreign exchange transactions varies according to the character of the business relations existing. Taking the relations between a home and branch office as being the most complex, operations may be carried on as follows:

1. Selling to or buying from a foreign concern, all billing to be done in domestic currency or all in foreign currency
2. Selling to or buying through a foreign branch, the method of doing business on the part of the branch being any of the following:
    (a) Branch sells to customers; proceeds collected by home office; or branch collects proceeds itself
    (b) Branch buys only from head office; or from head office and other dealers as well; branch may even carry on its own manufacturing
    (c) Branch pays its own bills; or same are paid by home office

There are many such methods of procedure.

The problem which enters into the accounting of foreign transactions is that of reflecting on the books or in the statements prepared from the books the conversion of foreign currency.

In the case of transactions with a foreign concern where the billing is in domestic currency there is no problem involved other than the usual one in similar transactions with domestic concerns. However, where the billing is done in foreign currency it becomes necessary to carry extra ledger columns in the account of the party involved. Sometimes a conversion is made only at the time of billing. In case a market rate of exchange, different from that used in converting the billing prevails, which will of course affect the amount of domestic currency received, the difference above or below the billing amount may be charged or credited to a nominal account often called "Profit or Loss on Exchange."

Where transactions are with a branch located in a foreign country, then either the foreign accounts may be kept by and at the home office, or at the branch itself. In the event of billing being done in domestic currency, then no other arrangement than perhaps that of separating the foreign accounts from the domestic accounts in the ledger need be resorted to; this, of course, referring to a case where the home office keeps the books. Where billing is done and transactions are in terms of foreign currency, then a separate set of books must be kept, either by the home office, or the branch--and by "set" is meant the books of original entry, journal, cash book, etc., as well as a ledger. Transactions recorded therein will be in foreign currency. Transactions between the branch and home office will be represented by "control" accounts on both the home office and branch books.

Thus far has been discussed the actual bookkeeping in connection with foreign exchange. Another important problem is of consolidating the accounts in one currency with those in another. Briefly stated the following governs:

1. Where the rate of exchange is sufficiently stable it is usual to convert the accounts on a fixed basis, in which case the only difference in exchange will arise in connection with remittances.

2. Where the exchange is of a fluctuating character, foreign accounts should be converted as follows:

(a) Fixed assets at original rate acquired
(b) Floating or current assets and liabilities at the rate on day of balance sheet
(c) Revenue items at the average rate of the period covered by the accounts
(d) Remittances at the actual rate
(e) Control balances at the same rate as that which had been established on the head office books at the last period. The difference in this amount and that on the head office control account will represent loss or gain in exchange to be carried to the Profit and Loss account. Sometimes, however, this is carried in a reserve account.

Journal entries to place the results of the branch on the books of the head office should be made using the rate above mentioned.

REFERENCES:

Dicksee, Advanced Accounting, pages 29-35
Kester, Vol. 2, Chapter XXXI

COMPLETE ACCOUNTING COURSE--PART II

Lecture 15

GENERAL REVIEW

Problem 34

The United States Cement Co. was formed on July 1, 1917, and the following trial balance was abstracted from the books at the close of its first fiscal year, or June 30, 1918.

	DEBITS	CREDITS
Capital Stock issued and outstanding		$450,000.00
First Mortgage 6% Bonds dated July 1, 1917		100,000.00
Real Estate	$ 66,000.00	
Buildings	180,000.00	
Machinery	285,000.00	
Tools and Equipment	10,000.00	
Heat and Power	4,200.00	
Mill Labor	27,600.00	
Factory Expenses	2,550.00	
Customers' Accounts	79,350.00	
Raw Materials Purchased	150,000.00	
Office Salaries and Expenses	5,175.00	
Notes Receivable	11,350.00	
Storekeeper (representing the purchases of supplies and spare parts)	9,500.00	
Petty Cash Fund	250.00	
Cash in bank	12,600.00	
Sales		184,875.00
Accounts Payable		48,000.00
Bills Payable		63,000.00
Discounts Received		1,200.00
Discounts Allowed	1,400.00	
Interest on Bills Receivable, Bank Balances, etc.		900.00
Interest on Bills Payable	3,000.00	
	$847,975.00	$847,975.00

The following items will have to be taken into consideration in arriving at the financial position of the company at June 30, 1918, and the results of operation for the year ending on that date:

1. Depreciation on buildings at 2½% per annum; on machinery, 7½% per annum; and on tools and equipment, 10% per annum
2. Accrued wages of workmen $1,875; accrued taxes $750; and accrued interest on bills payable of $875

3. Reserve for bad and doubtful accounts of 1% on the sales for the year
4. Of the total materials and supplies purchased and charged to the storekeeper, $7,400 was used (per storekeeper's reports) in connection with the manufacture of cement. The balance is still on hand.
5. Accrued interest on First Mortgage 6% Bonds, payable July 1, 1918
6. Inventory of cement on hand June 30, 1918

Prepare the following:

(a) Statement showing cost of cement produced (250,000 barrels) for the year and the average cost per barrel
(b) Finished Product Account (30,000 barrels on hand June 30, 1918)
(c) Balance Sheet at June 30, 1918
(d) Statement of Profit and Loss Account for the year ending June 30, 1918

GENERAL REVIEW QUESTIONS

Question 71--

(a) State the purpose for which a statement of affairs is prepared; a realization and liquidation account.
(b) Draft the forms you would use if called upon to prepare either of these statements.

Question 72--Draft the entries required to close the books of a liquidating corporation after the final dividend has been paid to the creditors.

Question 73--Distinguish between the following operating statements:

(a) Statement of profits and income
(b) Statement of profit and loss account
(c) Manufacturing, trading, and profit and loss account
(d) Revenue statement
(e) Profit and loss account
(f) Statement of receipts and disbursements
(g) Statement of income and expense

Question 74--Draft the forms generally used for:

(a) Statement of profits and income
(b) Manufacturing, trading, and profit and loss account

Question 75--

(a) Give the entries required to set up a Manufacturing Account and a Cost of Sales Account
(b) What is the balance of each of these accounts supposed to represent?

Question 76--Give the entries required to open the books of a new partnership.

Question 77--Give the entries required to close the books of a partnership

(a) At the end of a fiscal period
(b) On dissolution due to death of a partner
(c) On dissolution caused by the sale of the net assets to a corporation

To what extent would the entries in (c) differ if the sale was made to a firm instead of to a company?

Question 78--State the rules governing the distribution of the assets of a partnership when it is dissolved

(a) Voluntarily
(b) Through insolvency

Question 79--In partnerships what is the rule for distributing

(a) Profits arising from operations?
(b) Extraordinary losses caused by the insolvency of the firm and the subsequent sale of its assets to a corporation?

Question 80--Give the entries required to open the books of a corporation

Question 81--Give the entries require to close the books of a corporation

(a) At the close of a fiscal period
(b) On dissolution (when the net assets are sold to another company)

To what extent would the entries in (b) differ if the net assets were sold to a partnership instead of a corporation?

Question 82--What is the basis upon which an expenditure for certain machinery should be distributed as between

(a) Capital Account
(b) Reserve for depreciation
(c) Deferred charges to operation
(d) Repairs and renewals
(e) Surplus

Question 83--What is the proper basis upon which the foregoing machinery should be valued in case the company built for its own use?

Question 84--A certain manufacturing concern makes tools and other equipment for use in its own plant and charges Capital Asset Accounts at the market value (which is in excess of cost) and credits the difference between market and cost values to the Profit and Loss Account of the period in which the tools and other equipment were manufactured. Is this correct? Why?

Would you alter your opinion if the credit were passed to a Capital Surplus Account?

Would you alter your opinion if the credit were passed to a Depreciation Reserve Account?

Question 85--On what basis should the following inventories be valued:

(a) Raw Materials
(b) Work in Progress
(c) Finished Product

Question 86--

(a) What is your understanding of the following terms, when applied to inventory valuations:
1. Market price
2. Selling price
3. Cost price
4. Replacement value

(b) How would you proceed to ascertain each of these prices if you desired to apply one of them to an inventory?

Question 87--How would you ascertain unit costs in the case of:

(a) Company manufacturing a bulk product
(b) Company manufacturing variety of products
(c) Retail grocery store

Question 88--Would unit costs be of any value to an auditor engaged in verifying an inventory?

Question 89--

(a) What do you understand by a Current Account?
(b) How would you state a Branch Office Current Account on the balance sheet of the home office?
(c) Would the procedure outlined in (b) be altered in any way if the branch office were located in Mexico City?

Question 90--What are contingent liabilities? How should they be stated on the balance sheet?

Solution to Problem 30

JONES, SIKES, ROBINSON AND WILSON
STATEMENT OF PROFIT AND LOSS
YEAR ENDING DECEMBER 31, 1918

EARNINGS:			
Jones and Robinson		$19,000.00	
Sikes and Wilson		23,000.00	
New Business		7,500.00	$49,500.00
DEDUCT--Preferential Allowances:			
Jones and Robinson	$2,850.00		
Sikes and Wilson	3,450.00	$ 6,300.00	
Expenses		16,725.00	
Bad Debts		1,300.00	
Interest Allowances on Net Assets and Cash:			
Jones and Robinson	$187.50		
Sikes and Wilson	175.00	362.50	24,687.50
NET PROFIT			$24,812.50
DISTRIBUTED AS FOLLOWS:			
Jones (3/10)		$7,443.75	
Sikes (3/10)		7,443.75	
Robinson (2/10)		4,962.50	
Wilson (2/10)		4,962.50	$24,812.50

SUMMARY OF CAPITAL ACCOUNTS

	JONES	SIKES	ROBINSON	WILSON	TOGETHER
Capital at Beginning	$ 9,750.00	$ 8,700.00	$ 6,500.00	$ 5,800.00	$30,750.00
ADD--					
Preferential Allowances					
15% on $19,000 (J & R)	1,710.00		1,140.00		2,850.00
15% on 23,000 (S & W)		2,070.00		1,380.00	3,450.00
Interest on Net Assets and Cash					
5% on $3,750 (J & R)	112.50		75.00		187.50
5% on 3,500 (S & W)		105.00		70.00	175.00
Profit	7,443.75	7,443.75	4,962.50	4,962.50	24,812.50
	$19,016.25	$18,318.75	$12,677.50	$12,212.50	$62,225.00
DEDUCT--Drawings	5,000.00	5,500.00	3,250.00	3,500.00	17,250.00
Capital at end	$14,016.25	$12,818.75	$ 9,427.50	$ 8,712.50	$44,975.00

Solution to Problem 31

THE A B COMPANY
COMPARATIVE STATEMENT OF PROFITS AND INCOME
YEARS ENDING DECEMBER 31, 1917, AND DECEMBER 31, 1918

PARTICULARS	1917 Amount	1917 Per Cent	1918 Amount	1918 Per Cent	INCREASE OR DECREASE(*) Amount	INCREASE OR DECREASE(*) Per Cent
Sales	$86,000.00	100.00	$107,000.00	100.00	$21,000.00	----
Cost of Sales	54,346.12	63.19	73,800.00	68.97	19,453.88	5.78
Gross Profit from Sales	$31,653.88	36.81	$ 33,200.00	31.03	$ 1,546.12	5.78*
DEDUCT--Selling and General Expenses:						
Salesmen's Salaries	$ 4,100.00	4.77	$ 5,600.00	5.23	$ 1,500.00	.46
Selling Expenses	1,800.00	2.09	2,000.00	1.87	200.00	.22*
Freight-out	324.00	.38	460.00	.43	136.00	.05
Officers' Salaries	4,000.00	4.65	5,000.00	4.67	1,000.00	.02
Office Expenses	2,236.42	2.60	1,550.00	1.45	686.42*	1.15*
	$12,460.42	14.49	$14,610.00	13.65	$ 2,149.58	.84*
Net Profit from Operations	$19,193.46	22.32	$18,590.00	17.38	$ 603.46*	4.94*
DEDUCT--Interest (Net)	523.50	.61	546.00	.51	22.50	.10*
Surplus Net Profits	$18,669.96	21.71	$18,044.00	16.87	$ 625.96	4.84*

*Red

ANALYSIS OF DECREASE IN NET PROFITS

Increase in Gross Profits due to increase in Sales (36.81% of $21,000)		$7,729.41
Decrease in Gross Profits due to proportionate Increase in Cost of Sales (5.78% of $107,000)		6,183.29
Total Increase in Gross Profits		$1,546.12
DEDUCT--Increase in General and Selling Expenses:		
Salesmen's Salaries	$1,500.00	
Selling Expenses	200.00	
Freight-out	136.00	
Officers' Salaries	1,000.00	
Less--Decrease in Office Expenses	686.42*	2,149.58
Decrease in Net Profits from Operation		$ 603.46*
Increase in Interest Paid	$499.50	
Increase in Interest Received	477.00	22.50
Net Decrease in Surplus Net Profits		$ 625.96*

*Red

ANSWERS TO QUESTIONS

Answer to Question 61--

(a) The purpose of a sinking fund reserve is to provide for the retirement of a debt out of earnings. The purpose of a depreciation reserve is to provide out of earnings for the loss in value of the depreciable property used by the business.

Both of these reserves are created by periodical charges to profit and loss. In the case of the sinking fund reserve, the periodical charge is generally stipulated in the deed of trust. In the case of the depreciation reserve, the periodical charge may sometimes be stipulated by agreement between the company and some class of its creditors or stockholders but is most often left to the discretion of the company.

The sinking fund reserve reverts to the Surplus Account when the debt for which it was created is retired. The depreciation reserve, if properly calculated, will be extinguished by charges incurred in the replacement of the worn-out property.

(b) Where the life of the debt to be retired by a sinking fund reserve is co-equal with the life of the property to be extinguished by a depreciation reserve, it would be reasonable (although hardly practicable) to consider the accumulated sinking fund reserve as the equivalent of the depreciation reserve. When the debt is retired the accumulated sinking fund reserve would be used to write off the value of the worn-out property.

The question of the manner in which either reserve is to be created and its ultimate disposition should be clearly dissociated from the question of the source from which the company will obtain funds to retire the debt or replace

the property. The creation of these reserves indicates that the stockholders are leaving in the business such portion of the earnings as are required to extinguish the debt or replace the property. Whether the resulting assets are to be carried in liquid form (and thus available for the retirement of the debt or the replacement of the property), or whether the assets are to be represented by additions to the original property investment, is a question of policy to be determined by the company in case there are no contractual stipulations.

Answer to Question 62--

(1)

Provision for Sinking Fund:		
(Profit and Loss account)	$130,000.00	
To--Sinking Fund Reserve		$130,000.00
Provision for sinking fund for the five years ended December 31, 1918, in accordance with the terms and conditions of the trust deed.		

(2)

Sinking Fund Assets	130,000.00	
To--Cash		130,000.00
Cash deposited with trustees under the terms and conditions of the trust deed.		

(3)

Sinking Fund Assets	2,983.27	
To--Sinking Fund Reserve		2,983.27
Increments to sinking funds in nature of interest on funds in the hands of the trustees.		

(4)

Bonds Redeemed	100,000.00	
To--Sinking Fund Assets		100,000.00
To record bonds redeemed by the trustees.		

Answer to Question 63--

(1)

Cash	$450,000.00	
Discount on Bonds	50,000.00	
To--First Mortgage 6% Bonds		$500,000.00
Proceeds from sale of $500,000 bonds at 90.		

(2)

New Plant	450,000.00	
To--Audited Vouchers		450,000.00

(3)

Audited Vouchers	450,000.00	
To--Cash		450,000.00

The discount on bonds should be amortized over the life of the bonds. That portion of the discount relating to the period of construction may be charged to the cost of the new plant. It would be improper to charge the entire discount to the new construction.

Answer to Question 64--Depreciation is an expense of conducting the business, and if properly calculated is just as certain a loss as wages, rent, or other expenses paid. The fact that the actual disbursements on account of depreciation are deferred does not alter the situation. A loss has occurred and that loss was caused by the operations of the business. Consequently provision must be made therefor before net earnings can be arrived at. To reduce the depreciation charge so as to increase the book net earnings and pay dividends therefrom, is in effect a payment of dividends out of capital. If such payments should cause the insolvency of the company, each of the directors authorizing such payment would be personally liable to the creditors for the amount so disbursed.

Where a liberal policy had prevailed in the past and the annual depreciation charge was larger than the amount actually required under the circumstances, the directors would be justified in reducing the provision for the current year provided that such reduction did not reduce the provision below a reasonable amount.

If the accumulated depreciation reserve was materially in excess of the requirements it may be allowable for the directors to authorize an adjustment between the depreciation reserve and the surplus. But any adjustment of this character should not reduce below a reasonable amount the depreciation provision charged to the Profit and Loss Account of the current period.

Answer to Question 65--The indorsement created a contingent liability in that if the maker of the notes should fail to pay same, recourse can be had on the B C Company. Inasmuch as these notes are unpaid at the date the balance sheet is prepared the contingent liability must be expressed thereon, preferably as a footnote to the balance sheet.

COMPLETE ACCOUNTING COURSE--PART II

Lecture 16

A SURVEY OF AUDITING

Problem 35

The following balance sheet of the M Co. shows the financial position of that company at December 31, 1917:

ASSETS		
CAPITAL ASSETS:		
Real Estate and Buildings	$60,000.00	
Machinery, Tools, and Fixtures	85,000.00	
Horses and Wagons	20,000.00	
Total Capital Assets		$165,000.00
CURRENT ASSETS:		
Inventories	$65,000.00	
Customers' Accounts	40,000.00	
Notes Receivable	15,000.00	
Cash on Hand and in Bank	5,000.00	
Total Current Assets		125,000.00
DEFERRED CHARGES TO INCOME:		
Prepaid Insurance Premiums	$ 1,000.00	
Prepaid Interest	500.00	1,500.00
Total Assets and Deferred Charges		$291,500.00
LIABILITIES		
CAPITAL LIABILITIES:		
Capital Stock Issued and Outstanding	$150,000.00	
First Mortgage 6% Bonds	50,000.00	
Total Capital Liabilities		$200,000.00
CURRENT LIABILITIES:		
Bank Loans	$ 45,000.00	
Trade Creditors	15,000.00	
Sundry Accounts	2,000.00	
Total Current Liabilities		62,000.00
SURPLUS		29,500.00
		$291,500.00

A year later, or on December 31, 1918, the following balance sheet was prepared from the books:

ASSETS

CAPITAL ASSETS:		
Real Estate and Buildings	$ 65,000.00	
Machinery, Tools, and Fixtures	90,000.00	
Horses and Wagons	25,000.00	
Total Capital Assets		$180,000.00
CURRENT ASSETS:		
Inventories	$129,000.00	
Customers' Accounts	45,000.00	
Notes Receivable	9,000.00	
Cash on Hand and in Bank	9,000.00	
Total Current Assets		192,000.00
DEFERRED CHARGES TO INCOME:	$ 1,200.00	
Prepaid Insurance Premiums	200.00	1,400.00
Prepaid Interest		
Total Assets and Deferred Charges		$373,400.00

LIABILITIES

CAPITAL LIABILITIES:		
Capital Stock Issued and Outstanding	$150,000.00	
First Mortgage 6% Bonds	50,000.00	
Total Capital Liabilities		$200,000.00
CURRENT LIABILITIES:		
Bank Loans	$ 60,000.00	
Trade Creditors	25,000.00	
Sundry Accounts	4,000.00	
Total Current Liabilities		89,000.00
SURPLUS ACCOUNT:		
Balance at January 1, 1918	$ 29,500.00	
ADD--Profits for the year	94,900.00	
	$124,400.00	
DEDUCT--Dividends declared and paid	40,000.00	84,400.00
Total Capital Stock, Liabilities, and Surplus		$373,400.00

Prepare statement showing what disposition has been made of the profits earned for the year ended December 31, 1918.

Problem 36

A firm of three partners with equal capital and interest operate for three years, when the junior partner withdraws.

The partnership agreement provides that a retiring partner shall, in addition to his capital and share of profits, receive by way of good-will two years' purchase of his share of the average profits shown for the three years next preceding the date of withdrawal.

Make out a balance sheet, statement of profits and income, and an account with the retiring partner as of June 30, 1919, from the following memorandum handed to you with your instructions, on September 3, 1919, allowing for depreciation on Plant account, 5%; on Leasehold account, 15%; and for discount and possible loss on Accounts Receivable, 10%. The profits for two previous years were respectively $44,540 and $55,050.

Capital	$ 60,000.00
Plant, Tools, and Equipment	37,000.00
Leasehold	11,250.00
Merchandise Inventory, July 1, 1918 (net after deducting Reserve of $13,470)	12,000.00
Merchandise Inventory, June 30, 1919	19,000.00
Accounts Receivable	48,500.00
Accounts Payable	46,975.00
Merchandise Sales	137,970.00
Merchandise Purchases	69,510.00
Wages	11,500.00
General Expense	3,900.00
Bank	10,035.00
A's Drawing Account	13,750.00
B's " "	13,750.00
C's " "	13,750.00

The inventory reserve is no longer required and can be written back.

QUESTIONS ON AUDITING

Question 91--What is an audit?

Question 92--State briefly the objects and advantages of an audit.

Question 93--Is it the duty of the auditor of a company to balance the books? Assuming you were requested to discover an error in the trial balance of a set of books, which the staff of a company had failed to detect, what steps would you take?

Question 94--What is the distinction between audit and accountancy work? If instructed by a private firm to perform the latter, how would vou limit your responsibility?

Question 95--What are the legal responsibilities of an auditor?

Solution to Problem 32

JOURNAL ENTRIES ON HOME OFFICE BOOKS

(1)		
London Branch Office	$480,000.00	
To--Cash		$480,000.00
Cash investment remitted to branch office @ 4.80.		
(2)		
Consignment-Outward #1	240,000.00	
To--Merchandise Purchases		240,000.00
Merchandise shipped on consignment to London branch.		
(3)		
Cash	120,000.00	
To--London Branch		120,000.00
Draft drawn against consignment #1 @ 4.80.		
(4)		
London Branch Office	47,500.00	
To--Merchandise Purchases		47,500.00
Merchandise shipped to branch office.		
(5)		
Cash	47,500.00	
To--London Branch Office		47,500.00
Draft @ 4.75 drawn against shipment in (4).		
(6)		
London Branch Office	47,600.00	
To--Merchandise Purchases		47,600.00
Merchandise shipped to branch office.		
(7)		
Cash	47,600.00	
To--London Branch Office		47,600.00
Draft @ 4.76 on shipment in (6).		
(8)		
London Branch	137,750.00	
To--Sales		137,750.00
Net sale of one-half of consignment #1.		
(9)		
Cash	137,750.00	
To--London Branch		137,750.00
Receipt of net proceeds from branch office on consignment #1.		

(10)

Cash	$380,000.00	
To--London Branch Office		$380,000.00
Remittance of portion of capital investment.		

(11)

Office Equipment, Branch Offices	24,000.00	
To--London Branch Office		24,000.00
Being the permanent expenditure transferred to Investment account.		

JOURNAL ENTRIES ON BRANCH OFFICE BOOKS

(1)

Cash	£100,000.0.0	
To--Home Office		£100,000.0.0
Cash investment received from home office.		

(2)

Office Equipment	5,000.0.0	
To--Cash		5,000.0.0
Office equipment purchased in London.		

(3)

Home Office	25,000.0.0	
To--Cash		25,000.0.0
Draft on consignment #1 paid.		

(4)

Purchases	40,000.0.0	
To--Creditors' Accounts		40,000.0.0
Merchandise purchased on account.		

(5)

Customers' Accounts	25,000.0.0	
To--Sales		25,000.0.0
Sale of one-half of purchase in (4) on account.		

(6)

Petty Cash Fund	1,000.0.0	
To--Cash		1,000.0.0
Petty cash fund established.		

(7)

Merchandise Purchases	10,000.0.0	
To--Home Office		10,000.0.0
Merchandise purchased from home office.		

(8)

Home Office	10,000.0.0	
To--Cash		10,000.0.0
Draft @ 4.75 on purchase from home office.		

(9)		
Merchandise Purchases	£10,000.0.0	
To--Home Office		£10,000.0.0
Merchandise purchased from home office.		
(10)		
Home Office	10,000.0.0	
To--Cash		10,000.0.0
Draft @ 4.76 on purchase from home office in (9).		
(11)		
Cash	30,000.0.0	
To--Consignment Sales		30,000.0.0
Sale of one-half of consignment #1.		
(12)		
Expenses on Consignments	100.0.0	
To--Cash		100.0.0
Expenses incurred on consignments.		
(13)		
Consignment Sales	1,000.0.0	
To--Expenses on Consignments		100.0.0
Commission		900.0.0
To close out Consignment Sales account.		
(14)		
Consignment Sales	29,000.0.0	
To--Home Office		29,000.0.0
To close out Consignment Sales.		
(15)		
Home Office	29,000.0.0	
To--Cash		29,000.0.0
Remittance of net proceeds to home office.		
(16)		
Home Office	80,000.0.0	
To--Cash		80,000.0.0
Remittance to home office of portion of investment.		
(17)		
Home Office	5,000.0.0	
To--Office Equipment		5,000.0.0
Transfer of Office Equipment account to home office.		

BRANCH OFFICE ACCOUNT ON HOME OFFICE BOOKS

Investment	$480,000.00	£100,000.0.0	Draft	$120,000.00	£25,000.0.0
Merchandise	47,500.00	10,000.0.0	Draft	47,500.00	10,000.0.0
Merchandise	47,600.00	10,000.0.0	Draft	47,600.00	10,000.0.0
Sales-Con-			Draft	137,750.00	29,000.0.0
signment	137,750.00	29,000.0.0	Draft	380,000.00	80,000.0.0
Balance	47,500.00	10,000.0.0	Office Equip-		
			ment acct.	24,000.00	5,000.0.0
			Foreign Exch.	3,500.00*	
	$760,350.00	£159,000.0.0		$760,350.00	£159,000.0.0

*Carried to Profit and Loss, or Reserve for Foreign Exchange.

HOME OFFICE ACCOUNT ON BRANCH OFFICE BOOKS

Draft--Consignment #1	£ 25,000.0.0	Investment	£100,000.0.0
Draft--Purchase	10,000.0.0	Purchases	10,000.0.0
Draft--Purchase	10,000.0.0	Purchases	10,000.0.0
Draft--Consignment Sales	29,000.0.0	Consignment Sales	29,000.0.0
Draft--Investment	80,000.0.0	Balance	10,000.0.0
Office Equipment	5,000.0.0		
	£159,000.0.0		£159,000.0.0

Solution to Problem 33

STATEMENT SHOWING RECONCILIATION OF THE
HOME OFFICE AND BRANCH OFFICE CURRENT ACCOUNTS

BALANCE--per home office books			$19,618.30
BALANCE--per branch office books			18,808.05
DIFFERENCE--being net debits of the home office not credited by the branch office as summarized below			$ 810.25
1. Items debited by the home office not credited by the branch office			
(a) Raw materials shipped but not yet received	$2,103.41		
(b) Cash advance	5,000.00		
(c) Advances to the branch manager	450.00		$ 7,553.41
2. Items debited by the branch office not credited by the home office			
(a) Payment to the American Steel Wks.	$4,000.00		
(b) Telegraph and other charges	304.77		4,304.77
3. Items credited by the branch office not debited by the home office			
(a) Balance of the Profit and Loss account for year		$11,047.93	
Balance--Net debits of the home office not credited by the branch office (as above)		810.25	
		$11,858.18	$11,858.18

In order to bring the two accounts into agreement it will be necessary to make the following entries:

ON THE HOME OFFICE BOOKS

(1)

Accounts Payable Controlling Account (American Steel Works)	$ 4,000.00	
Telegraph and other charges	304.77	
To--Branch Office Account		$ 4,304.77

Charges of the branch office not taken up by the home office (as per details) contained in the last current account received from the branch.

(2)

Branch Office Account	11,047.93	
To--Branch Office--Profit and Loss		11,047.93

To take up the profits of the branch office for the year as shown by their current account and the detailed statement of Profit and Loss account attached thereto.

ON THE BRANCH OFFICE BOOKS

Raw Materials Account	$2,103.41	
Cash	5,000.00	
Advance to the Branch Manager	450.00	
To--Home Office Account		$7,553.41

Charges of the home office not taken up by the branch office.

Another form commonly used is as follows:

STATEMENT SHOWING RECONCILIATION OF THE HOME OFFICE AND BRANCH OFFICE CURRENT ACCOUNTS

1. Home Office charges branch office does not credit:		1. Home office credits branch office does not charge	$---------
(a) Merchandise shipped by home office but not yet received by branch	$ 2,103.41	Total	$---------
(b) Cash advanced by home office not credited by branch	5,000.00		
(c) Advances to branch manager on account of traveling expenses not credited by branch office	450.00		
Total	$ 7,553.41		
2. Branch office charges home office does not credit:		2. Branch office credits home office does not charge:	
(a) Payment to the American Steel Works on account of steel purchased by home office	$ 4,000.00	(a) Balance of branch Profit and Loss account for year	$11,047.93
		3. Balance (as above)	810.25
(b) Telegraph and other charges during period chargeable to home office	304.77		
Total	$ 4,304.77		
	$11,858.18		$11,858.18

ANSWERS TO QUESTIONS

Answer to Question 66--One plan of reconciling ordinary branch office accounts with the home office accounts is to reverse the balance of the branch office accounts with the home office accounts. (This is on the books of the home office.)

Then take the home office account on the branch office books and show the balance of that account reversed. Add to this the items opened in the branch office account on the books of the home office not taken up by the branch office. Then add the open items on the head office books with the head office account on the branch office. The columns should balance.

Since in case of reconciling home office books with foreign office books, foreign money is shown in the branch account, the reconciliation is made in foreign currency.

Answer to Question 67--

LONDON TRIAL BALANCE

ACCOUNTS	RATE OF CONVERSION
New York Office	Rate at beginning of period represented in balance of this account
Remittances	Actual cost of remittances
Cash	Current rate
Customers' accounts	Current rate
Inventory	Current rate at end of last period
Furniture and Fixtures	Rate at time of purchase
Creditors' accounts	Current rate
Sales	Average rate
Purchases	Average rate
Expenses	Average rate

Inventory at end of period should be converted at the current rate.

Answer to Question 68--

(a)

(1)

Depository (under the exchange plan)	$1,000,000.00	
To--First Mortgage 6% Bonds		$1,000,000.00
To record the par value of the first mortgage 6% bonds deposited with .... to be delivered to preferred stockholders in exchange for preferred shares, per resolutions adopted by the stockholders at a meeting held on		

(2)

Preferred Stock	$1,000,000.00	
To--Depository (under the exchange plan)		$ 1,000,000.00
To record the preferred stock received from the depository--the same having been turned in by the preferred stockholders in exchange for $1,000,000 of first mortgage 6% bonds of an equivalent value--per resolutions adopted by the stockholders at a meeting held on		

(b)

Premium on Preferred Stock (later transferred to Surplus Account)	5,000.00	
Preferred Stock	100,000.00	
To--Cash		105,000.00
Cash paid in retirement of preferred stock, $100,000 (par value).		

Answer to Question 69--

(a)

Cash	$402,500.00	
To--Preferred Stock		$350,000.00
Premium on Preferred Stock		52,500.00
To record sale of $350,000 preferred stock at 115. Under terms of issue no part of the premium is available for dividends.		

(b)

JULY 1, 1919

First Mortgage 6% Bonds	$300,000.00	
Premium on Retirement of First Mortgage 6% Bonds	7,500.00	
To--Cash		$307,500.00
To record retirement of $300,000 first mortgage 6% bonds due July 1, 1920, at 102½, in accordance with terms of trust deed.		

The premium on preferred stock referred to in (a) would be carried as a separate item on the balance sheet immediately below the capital stock. The premium paid on retirement of the first mortgage 6% bonds would be charged off during the year. On the statement of profits and income it would be shown as an extraordinary expenditure and deducted after net profits from operation had been ascertained.

The cost of the purchase of $50,000 (par value) of the preferred stock of the R Manufacturing Co. for $60,000 would be charged to an appropriate account to record the investment.

Answer to Question 70--

(a) If these bonds represent the company's own bonds held in the treasury, it will be necessary to qualify the assets as follows:

Treasury Bonds (Deposited as collateral to secure bank loans of $50,000)	$200,000.00

Similarly, the liability of Notes Payable would be qualified, viz.:

Bank Loans (Secured by $200,000 of first mortgage 6% bonds deposited as collateral)	$150,000.00

(b) The fact that $125,000 of the total accounts receivable of $198,093.11 is in dispute is an essential one to be brought out on the face of the balance sheet. It may or may not be a recoverable asset, but the fact that it is in dispute suggests that some loss will be sustained in the realization of the accounts. An auditor, if he errs at all, had better do so on the conservative side. The exact procedure would depend on the peculiar circumstances surrounding the case. A Reserve for Bad Debts should be set up for any amount adequate to cover any probable loss; or the words "See footnote" should be placed after the caption of Accounts Receivable. In the footnote there would be given an adequate explanation of the disputed acccounts.

REFERENCES:
Montgomery, pages 1-58
Wildman, pages 1-20

F. L. Barnes & Co.
Audit Year ending December 31, 1918
Miscellaneous Information - page 1

Audit made by Arthur F. Johnson of Arthur Anderson & Co., Certified Public Accountants, commencing February 3, 1919 and ending February 11, 1919. Junior Assistant, M. G. Gale.

Nature of audit: Balance sheet audit year ending December 31, 1918; detailed audit for months of April and December. Audit for previous year made by Rex Audit Co., a local firm of Certified Public Accountants.

Factory and Factory Office - 3560-66 S. Racine Ave., Chicago, Ill.

General and Sales Office - 1490 Edison Bldg., 72 W. Adams St. Chicago, Ill.

Manufacturers of Kitchen Cabinets - small sales office in 5th Ave. Bldg. N.Y. - advertise in Good Housekeeping, etc. and have OK of Good Housekeeping Institute.

Trade Name of "Perfection Kitchen Cabinet" with the following style numbers and prices —

Style 180 -	Small size - 4 drawer - 16 compartments - retail price	$ 60.00
181 -	Medium size - 7 drawer - 25 compartments - retail	78.00
183 -	Medium size - 7 drawer - 30 compartments - retail	96.00
185 -	Large size - 14 drawer - 36 compartments - retail	111.00
187 -	Large size - 16 drawer - 36 compartments - retail	120.00

These styles and prices are in the 1916, 1917 and 1918 catalogues.

According to Mr. M. J. Barnes a small proportion of the sales come from the consumer direct while the wholesale end is handled by the Improved Kitchen Cabinet Co., a selling agent also for the Harmon Kitchen and the Grand Rapids Household Devices Co. Direct sales are the result of advertising in women's periodicals and newspapers and about 25% are made on the installment plan; i.e. 1/3 down and the balance in installments of 1/3 each, one month apart. Prices to Improved Kitchen Cabinet Co. are as above less 20%, if they purchase 100 of any one style for the year an additional 2% for that particular style will be allowed, same to be applied in reduction of outstanding account.

Officers etc. —

Frank L. Barnes, President	Vance L. Mannheim, Factory Superintendent
H. E. Barnes V.P. and Genl. Manager	Niles Boardman, Cashier
Myron J. Barnes, Secy.-Treas. and Credit Manager	Dwight Frazer, Petty Cashier and bookkeeper
Geo. M. Addison, In charge of books	Dugan E. Sanders, Time Clerk

F. L. Barnes & Co.

1

Miscellaneous Information, page 2

Approximately 75 Factory Employes; 8 General Office Employes; 1 in Sales Dept.

Incorporation—

The present company is the outgrowth of F.L. Barnes & Sons, originally established about 1900, no books being kept until 1905. This was a partnership making table tops, desk panels and slides, etc. until January 1, 1915, at which date F.L. Barnes & Co. was organized and incorporated under the Laws of the state of Illinois. The incorporators were:

Frank L. Barnes
Howard E. Barnes (Son of F.L.)
Myron I. Barnes (brother of F.L.)

The corporation took over the business of the partnership together with its assets and liabilities, and the partnership dissolved. On Jan 1, 1915, the following entry was made on the books of the new corporation:

Land	$ 32,250.00	
Buildings	87,428.91	
Buildings-Moveable Equipment & Fixtures	11,330.07	
Machinery	84,987.41	
Good-will	50,000.00	
Accounts Receivable	6,475.08	
Cash	7,501.01	
To- Notes Payable		$ 26,000.00
Accounts Payable		3,972.43
F.L. Barnes & Sons, Vendors		250,000.00

To record purchase of net assets of F.L. Barnes & Sons as per minutes of stockholders' meeting held on Jan. 1, 1915.

Authorized issue of stock (all common) was 2,500 shares-par value $100 each
1,500 shares were issued to the partnership, the balance of $100,000 being paid in notes.

D.B. Story Manufacturing Co.—

Mr. D.B. Story was a brother-in-law of F.L. Barnes and conducted a similar business. At his death in December 1916, F.L. Barnes & Co. took over from the widow 200 shares of the D.B. Story Mfg. Co. common, giving her 3 shares of F.L. Barnes common for each 2 shares of the former. There are two other stockholders:

A. G. Somers 30 shares
Jack Boyle 20 shares

Stock ownership has remained unchanged, the minority stockholders refusing to part with their holdings. Mr. F.L. Barnes states that negotiations are still in progress as to the consolidation of the two corporations.

COMPLETE ACCOUNTING COURSE--PART II

Lecture 17

CASH AND CASH FUNDS

Problem 37

The trial balance of A B Co. on January 1, 1919, appears as follows:

Cash	$ 50,100.00	Reserve for Disc. Accts. Receivable, January 1, 1918	$ 12,000.00
Accounts Receivable, Gross	400,000.00	Reserve for Disc. Mdse. Inventory, January 1, 1918	12,000.00
Notes Receivable	30,000.00	Accounts Payable	90,000.00
Merchandise Inventory, January 1, 1918, Gross	240,000.00	Notes Payable	600,000.00
Merchandise Purchases, to January 1, 1919	1,250,000.00	Sales	1,500,000.00
Prepaid Interest, January 1, 1918	12,500.00	Purchase Discounts Collected on Settlements with Creditors	59,500.00
Interest, Paid to July 1, 1919	36,000.00	Reserve for Bad Debts, January 1, 1918	3,000.00
Expenses, Paid to January 1, 1919	156,000.00	Mdse. Returned to Creditors, to January 1, 1919	50,000.00
Reserve for Disc. Accts. Payable January 1, 1918	4,000.00	Collected on Accts. charged to Profit and Loss in 1917	500.00
Bad Debts, Charged Off to January 1, 1919	2,500.00	Credit Insurance, Received on 1917 Losses	1,000.00
Returned Sales Customers	100,000.00	Profit and Loss, January 1, 1918	55,000.00
Salaries	20,000.00	Capital Stock	225,000.00
Taxes	5,000.00		
Plant	250,000.00		
Discounts Allowed Customers	51,900.00		
	$2,608,000.00		$2,608,000.00

The following information is stated:

Accounts Payable, January 1, 1918, gross $80,000.
Accounts Receivable, January 1, 1918, gross $300,000.
Notes Payable, January 1, 1918, $500,000. Interest paid at 5% to July 1, 1918.
On July 1, 1918, $500,000 is renewed at 6% for 1 year and $100,000 additional borrowed at same rate for one year.
Inventory January 1, 1919, $320,000 gross.

Goods bought on terms of 5% 30 days.
Goods sold on terms of 4% 30 days.
Reserve for bad debts, January 1, 1919, to be 1% on gross Accounts Receivable.

Submit statement of profits and income and balance sheet.

Problem 38

You are called upon to make up a statement of the condition of a business which has been running for a few years at a loss, but to which has been added a new feature, upon the possibilities of which and his own financial responsibility outside of the business, the proprietor has succeeded in negotiating a loan. The books have not been well kept, but the following particulars can be obtained from them:

Merchandise purchased during the year	$50,000.00
Total sales for year	40,000.00
Borrowed from John Smith	30,000.00
Fixtures purchased during the year	5,000.00
Expenses for year	20,000.00
Proprietor's drawings during the year	3,000.00
Cash on hand, December 31, 1917	1,300.00
Accounts receivable, December 31, 1917	5,000.00
Accounts payable, December 31, 1917	15,000.00
Merchandise inventory new department, December 31, 1917	25,000.00

The books on January 1, 1917, showed the following balances:

Cash on hand	$ 300.00
Accounts receivable	2,000.00
Fixtures	2,000.00
Accounts payable	3,000.00
Capital	5,000.00
Advances to employees	2,000.00

On January 1, 1917, the bookkeeper had made up the following statement intended for a balance sheet at that date:

Cash	$ 300.00	Accounts Payable	$3,000.00
Accounts Receivable	4,000.00	Loan from Mary White	6,000.00
Fixtures	2,000.00		
Deficit	2,700.00		
	$9,000.00		$9,000.00

Without calculating interest or depreciation make up a profit and loss account for 1917 and a balance sheet as of December 31, 1917.

QUESTIONS ON AUDITING

Question 96--

(a) Differentiate between a "balance sheet" audit and "detail" audit.
(b) What do you understand by a "cash" audit?

Question 97--Outline an adequate system of internal check and state whether the system outlined is intended to apply to a particular enterprise.

Question 98--In an audit of the cash transactions would you regard it essential to verify the footings of the cash book and trace the postings therefrom to the ledger? State your reasons.

Question 99--State briefly how you would verify the following apparent reconcilement of cash at the close of an audit:

Cash on hand as per cash book		$3,810.00
Balance as per bank pass book	$5,610.00	
Add check of A B, not deposited	400.00	
	$6,010.00	
Deduct checks drawn, but not paid by bank	2,500.00	
	$3,510.00	
Cash in drawer	300.00	$3,810.00

Question 100--If the cash in bank as shown by the cash book or ledger is reconciled with the amount shown by the pass book or certificate obtained from the bank, is it necessary to check the pass book with the deposits as shown by the cash book? Give reasons for your answer, stating the nature of a possible irregularity that might be disclosed by such detail checking.

Solution to Problem 34

Exhibit I

UNITED STATES CEMENT COMPANY
BALANCE SHEET, JUNE 30, 1918

ASSETS

	Cost	Depreciation Reserve	Book Value
CAPITAL ASSETS:			
Real Estate	$ 66,000.00	$---------	$ 66,000.00
Buildings	180,000.00	4,500.00	175,500.00
Machinery	285,000.00	21,375.00	263,625.00
Tools and Equipment	10,000.00	1,000.00	9,000.00
	$541,000.00	$26,875.00	$514,125.00
CURRENT ASSETS:			
Inventory of Cement and Supplies		$28,506.00	
Customers' Accounts	$79,350.00		
Bills Receivable	11,350.00		
	$90,700.00		
Less--Reserve for Bad Debts	1,848.75	88,851.25	
Cash on Hand and in Bank		12,850.00	130,207.25
			$644,332.25

LIABILITIES

CAPITAL STOCK:		
Issued and Outstanding		$450,000.00
FIRST MORTGAGE 6% BONDS		100,000.00
CURRENT LIABILITIES:		
Bills Payable	$63,000.00	
Accounts Payable	48,000.00	111,000.00
ACCRUED LIABILITIES NOT DUE:		
Taxes	$ 750.00	
Wages	1,875.00	
Interest on Bills Payable	875.00	
Bond Interest	6,000.00	9,500.00
		$670,500.00
DEFICIENCY ACCOUNT:		
Net Loss for year ending June 30, 1918		* 26,167.75
		$644,332.25

* Red.

Exhibit II

UNITED STATES CEMENT COMPANY
STATEMENT OF PROFITS AND INCOME
FISCAL YEAR ENDING JUNE 30, 1918

(Number of barrels sold, 220,000)

		AMOUNT	PER BBL.
Gross Sales		$184,875.00	$0.8404
DEDUCT--Discounts Allowed		1,400.00	.0064
Net Proceeds from Sales		$183,475.00	.8340
DEDUCT--Cost of Cement Sold (Exhibit III)		193,644.00	.8802
Loss from Mill Operations		$ 10,169.00	.0462
DEDUCT--MISCELLANEOUS INCOME:			
Interest on Bills Receivable, Bank Balances, etc.		900.00	.0041
		$ 9,269.00	.0421
ADD--GENERAL AND ADMINISTRATIVE EXPENSES:			
Office Salaries and Expenses	$5,175.00		
Bad and Doubtful Accounts	1,848.75	7,023.75	.0319
TOTAL LOSS FROM OPERATION		$ 16,292.75	.0740
ADD--INTEREST ON BORROWED MONEY:			
On Bonds	$6,000.00		
On Bills Payable	3,875.00	9,875.00	.0450
TOTAL LOSS CARRIED TO DEFICIENCY ACCOUNT		$ 26,167.75	$0.1190

Exhibit III

UNITED STATES CEMENT COMPANY
STATEMENT OF COST OF CEMENT PRODUCED
YEAR ENDING JUNE 30, 1918

PARTICULARS	AMOUNT	PER BBL.
Raw Material Used	$150,000.00	
Mill Labor	29,475.00	
Heat and Power	4,200.00	
Taxes	750.00	
Factory Expenses	2,550.00	
Sundry Materials and Supplies	7,400.00	
Depreciation on Buildings, Machinery, Tools, and Equipment	26,875.00	
	$221,250.00	$0.8850
DEDUCT--Discounts Received	1,200.00	.0048
Cost of Cement Produced	$220,050.00	$0.8802

CEMENT STOCK ACCOUNT

PARTICULARS	NO. OF BBLS.	PER BBL.	AMOUNT
Inventory	-------	$ -----	$---------
Cost of Cement Produced	250,000	.8802	220,050.00
	250,000	$ .8802	$220,050.00
Cost of Cement Sold (Exhibit II)	220,000	$ .8802	$193,644.00
Inventory, June 30, 1918	30,000	.8802	26,406.00
	250,000	$0.8802	$220,050.00

ADJUSTING JOURNAL ENTRIES

(1)

Depreciation on Buildings	$ 4,500.00	
Depreciation on Machinery	21,375.00	
Depreciation on Tools and Equipment	1,000.00	
To--Reserve for Depreciation		$26,875.00

To provide depreciation for the fiscal year ending June 30, 1918, as set out in the following summary:

ASSET	BOOK VALUE	ANNUAL RATE	AMOUNT OF DEPRECIATION
Buildings	$180,000.00	2½%	$ 4,500.00
Machinery	285,000.00	7½%	21,375.00
Tools and Equipment	10,000.00	10 %	1,000.00
	$475,000.00		$26,875.00

(2)

Mill Labor	$1,875.00	
To--Accrued Wages		$1,875.00

To take up the accrued wages at June 30, 1918.

(3)

Taxes	750.00	
To--Accrued Taxes		750.00

To take up the accrued taxes to June 30, 1918.

(4)

Interest on Bills Payable	875.00	
To--Accrued Interest on Bills Payable		875.00

To take up the accrued interest on Bills Payable at June 30, 1918.

(5)

Bad and Doubtful Accounts	$1,848.75	
To--Reserve for Bad and Doubtful Accounts		$1,848.75
1% on sales for year.		

(6)

Sundry Materials and Supplies Used	7,400.00	
To--Storekeeper		7,400.00
Materials and supplies used during the year ended June 30, 1918, as per storekeeper's distribution reports.		

(7)

Bond Interest	6,000.00	
To--Accrued Interest on First Mortgage 6% Bonds		6,000.00
To take up the accrued interest on the first mortgage 6% bonds for the fiscal year ending June 30, 1918.		

CLOSING ENTRIES

(1)

Raw Materials Used	$150,000.00	
To--Raw Materials Purchased		$150,000.00
Cost value of raw materials used per storekeeper's distribution report.		

(2)

Manufacturing Account	220,050.00	
Discounts Received	1,200.00	
To--Raw Materials Used		150,000.00
Mill Labor		29,475.00
Heat and Power		4,200.00
Taxes		750.00
Factory Expenses		2,550.00
Sundry Materials and Supplies		7,400.00
Depreciation		26,875.00
To close manufacturing expense accounts.		

(3)

Cement Stock Account	220,050.00	
To--Manufacturing Account		220,050.00
To transfer cost of manufacturing cement.		

(4)

Cost of Cement Sold	193,644.00	
To--Cement Stock Account		193,644.00
To debit Cost of Cement Sold account with the cost value of 220,000 barrels of cement sold during the year ending June 30, 1918.		

(5)

Trading Account	$195,044.00	
To--Cost of Cement Sold		$193,644.00
Discounts Allowed		1,400.00
To close latter accounts.		

(6)

Sales	184,875.00	
To--Trading Account		184,875.00
To close Sales account.		

(7)

Profit and Loss Account	10,169.00	
To--Trading Account		10,169.00
To transfer gross loss on sales to Profit and Loss account.		

(8)

Profit and Loss Account	15,998.75	
Interest on Bills Receivable, etc.	900.00	
To--Office Salaries and Expenses		5,175.00
Bad and Doubtful Accounts		1,848.75
Interest on Notes Payable		3,875.00
Bond Interest		6,000.00
To transfer sundry accounts to Profit and Loss.		

(9)

Deficiency Account	26,167.75	
To--Profit and Loss Account		26,167.75
To transfer total loss for year ending June 30, 1918, to Deficiency account.		

REFERENCES:

Montgomery, pages 59-71; 296-312

Wildman, pages 21-41; 78-101

J. L. Barnes & Co.

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Count of Petty Cash - February 3, 1919

Ledger Account				$500.00		Remarks
Currency -						
Cash Drawer -	No.	Unit		Amount		
	18	$5		90.00 ✓		
	4	2		8.00 ✓		
	57	1		57.00 ✓		
	14		.50	7.00 ✓		
	15		.25	3.75 ✓		
	6		.10	.60 ✓		
	21		.05	1.05 ✓		
	3		.01	.03 ✓		
Safe -	2	packages 1		100.00 ✓		
	3	"	.50	30.00 ✓		
	1	"	.10	10.00 ✓		
	2	"	.05	4.00 ✓		
	1	"	.01	.50 ✓	$311.93	This amount checked with tally slip in cash drawer.
Checks -						
Geo. Booth	Irving Pk. National Bank	2/1		51.13		Accomodation check. OK'd by H. E. Barnes
The Fair	Cont. & Comm. Nat'l Bank	2/2		14.50	65.63	Cash Sale - OK'd by H. E. B.
Vouchers -						
Acme Window Cleaning Co.	Inv	2/2		10.25		
Johnson Tire Co. - Auto Repairs	Inv	2/2		7.14		
Tribune Co. Want Ad.	Inv	2/2		6.23		
J. L. Barnes I.O.U.		2/1		75.00		
Carbonic Supply Co. Shop Supplies	Inv	2/1		8.82		
S. Slayuka - Watchman discharged OK'd by		PM		15.00	122.44	
As above -					$500.00	OK Dwight Frazer Petty Cashier

The petty cash fund was reimbursed 1/10/19 and 1/31/19; examined vouchers covering same and found -

Date of Invoice	From	Explanation	Vou. No.	Amount
Dec. 12, 1918	Marshall Field & Co.	2 Office Desks	1561	$ 78.80
Dec. 31, 1918	City of Chicago	Garbage Disposal a/c	1543	17.50
Dec. 30, 1918	Consumers Gas Co.	December Gas	1580	56.00
Nov. 16, 1918	Nick Borlander	Office Plumbing Repairs	1575	64.13
Dec. 28, 1918	Tribune Co.	Page Ad.	1581	281.18

All other items were 1919 expenditures.
Petty Cashier was reimbursed Dec. 31, 1918

F. L. Barnes & Co.

Reconciliation of Bank Balance as of Dec. 31, 1918

Commerce National Bank, Clark and Adams, Chicago, Ill.

Balance per bank statement Dec. 31, 1918					$ 17,142.18
Balance per books " " "					14,107.05
Difference to be accounted for					$ 3,035.13
Which is accounted for as follows =					
Checks Outstanding =					
In Favor of	Dated	Canceled	Number		Amount
James Guthrie	11/30/18	1/2/19	15714		$ 15.25
F. J. Jacobson & Co	12/14/18	1/2/19	16057		457.00
Arnold & Co	12/16/18	1/16/19	16111		36.10
Bass Engine Co	12/30/18	1/7/19	16942		2,500.00
					$ 3,008.35

The above checks totaling $3,008.35, were found among the canceled checks returned with the January statement. In addition there are two payroll checks which have been outstanding since 1915 and 1916 (and it has been recommended that they be written off) as follows =

John Kaguko	10/14/15	– –		$ 15.12	
J. N. Thomas	3/22/16	– –		11.66	26.78
					$ 3,035.13

COMPLETE ACCOUNTING COURSE--PART II

Lecture 18

RECEIVABLES

Problem 39

From the following balance sheets of the A X Company prepare a statement showing application of funds during the year 1917:

ASSETS

	DEC. 31, 1916		DEC. 31, 1917
Land	$ 15,000.00	(1)	$ 20,000.00
Buildings	250,000.00		250,000.00
Machinery and Equipment	305,000.00	(2)	315,000.00
Investments (Temporary)	65,000.00	(3)	71,500.00
Treasury Stock (Preferred)	15,000.00		30,000.00
Inventories	88,000.00		65,500.00
Accounts Receivable	104,000.00		86,000.00
Cash	2,500.00		18,100.00
Prepaid Expenses	5,000.00		4,000.00
Unamortized Bond Discount	12,000.00		11,000.00
	$861,500.00		$871,100.00

LIABILITIES

Capital Stock--Common (Authorized, $500,000)	$150,000.00		$175,000.00
Capital Stock--Preferred (Authorized, $150,000; to be redeemed and canceled at the rate of $15,000 per year, commencing December 31, 1916)	150,000.00		150,000.00
First Mortgage Bonds (sold at 80; due January 1, 1929)	200,000.00		200,000.00
Accounts Payable	145,000.00		62,000.00
Sinking Fund Reserve	80,000.00		90,000.00
Reserve for Depreciation	45,000.00	(2)	58,000.00
Surplus January 1, 1917	91,500.00	(4)	83,400.00
Surplus Net Profits 1917			52,700.00
	$861,500.00		$871,100.00

NOTES--

(1) Increase caused by entry crediting Profit and Loss, 1917.

(2) Equipment discarded in 1917 (no scrap), \$25,000; charged to Reserve for Depreciation.

(3) A dividend of 10% on the temporary investment of \$65,000 was declared December 20, 1917, payable February 1, 1918.

(4) Dividend of 6% on preferred stock declared and paid January 5, 1917.

Problem 40

The Western Manufacturing Co. is engaged in the manufacture of a bulk product. At December 31, 1918, the trial balance abstracted by the bookkeeper was as follows:

PARTICULARS	DEBIT	CREDIT
Plant	\$400,000.00	
Inventory of Raw Material January 1, 1918	40,000.00	
Inventory of Work in Progress January 1, 1918	10,000.00	
Inventory of Finished Product January 1, 1918	12,500.00	
Customers' Accounts	48,000.00	
Cash in Bank and on Hand	11,500.00	
Insurance Unexpired	1,200.00	
Capital Stock (Authorized \$400,000)		\$350,000.00
Surplus		51,000.00
First Mortgage 6% Gold Bonds Issued		150,000.00
Accounts Payable		35,000.00
Reserve for Depreciation		10,000.00
Materials Purchased	168,000.00	
Direct Labor	40,000.00	
Heat, Light, and Power	3,500.00	
Miscellaneous Factory Expenses	12,500.00	
Discount on Sales	7,000.00	
Office Salaries and Expenses	21,000.00	
Salesmen's Salaries and Expenses	62,000.00	
Sales		228,000.00
Return Purchases of Materials		8,500.00
Miscellaneous Income		4,700.00
	\$837,200.00	\$837,200.00

Allow 1% for depreciation; 1½% of outstanding accounts receivable for bad debts; 6% per annum for accrued bond interest; and \$500 for accrued wages.

Twelve thousand five hundred tons of finished product having a market value of \$12,250 were on hand at January 1, 1918; 200,000 tons were produced during the year; 190,000 tons were sold. The market price at December 31, 1918, was \$1.50 per ton. At December 31, 1918, the inventories of raw material and work in progress aggregated \$10,000 and \$6,000, respectively.

Prepare:

(a) Balance sheet

(b) Statement of profits and income

(c) Statement of cost of manufacture

(d) Finished stock account

QUESTIONS ON AUDITING

Question 101--State the procedure you would adopt to verify the customers' accounts receivable and satisfy yourself as to the sufficiency of the reserve provided for bad and doubtful accounts.

Question 102--A wholesale house employs collectors, whose business it is to call on customers of the house within a radius of ten miles from their office and collect outstanding accounts. You are asked to design a system to prevent peculation on their part. Indicate the nature of the system you would advocate.

Question 103--In a detailed audit to what extent do you consider it advisable to check the debits to the accounts in the customer's ledger? State the object to be attained by such a check.

Question 104--How would you satisfy yourself as to the accuracy of the officers' accounts appearing on the balance sheet?

Question 105--How would you audit the Notes Receivable shown by the balance sheet of:

(a) Agricultural implement manufacturer
(b) Retail department store

Solution to Problem 35

M COMPANY
COMPARATIVE BALANCE SHEETS
AS AT DECEMBER 31, 1917 AND 1918

ASSETS

	DEC.31, 1917	DEC.31,1918	INCREASE	DECREASE
Real Estate, Buildings	$ 60,000.00	$ 65,000.00	$ 5,000.00	
Machinery, Tools, Fixtures	85,000.00	90,000.00	5,000.00	
Horses and Wagons	20,000.00	25,000.00	5,000.00	
Inventories	65,000.00	129,000.00	64,000.00	
Customers' Accounts	40,000.00	45,000.00	5,000.00	
Notes Receivable	15,000.00	9,000.00		$6,000.00
Cash on Hand and in Bank	5,000.00	9,000.00	4,000.00	
Prepaid Insurance Premiums	1,000.00	1,200.00	200.00	
Prepaid Interest	500.00	200.00		300.00
	$291,500.00	$373,400.00	$88,200.00	$6,300.00

LIABILITIES

Capital Stock	$150,000.00	$150,000.00	
First Mortgage 6% Bonds	50,000.00	50,000.00	
Bank Loans	45,000.00	60,000.00	$15,000.00
Trade Creditors	15,000.00	25,000.00	10,000.00
Sundry Accounts	2,000.00	4,000.00	2,000.00
Surplus	29,500.00	84,400.00	54,900.00
	$291,500.00	$373,400.00	$81,900.00

CHANGE IN FINANCIAL CONDITION

The profits for the year under review were applied in the following manner:

1. Dividends declared and paid		$40,000.00
2. Increase in Capital Assets, represented in:		
Real Estate and Buildings	$5,000.00	
Machinery, Tools, Fixtures	5,000.00	
Horses and Wagons	5,000.00	15,000.00
3. Increase in the Working Capital as shown in the following table		39,900.00
Total		$94,900.00

CURRENT ASSETS:	DECEMBER 31 1917	1918	INCREASE	DECREASE
Inventories	$ 65,000.00	$129,000.00	$64,000.00	
Customers' Accounts	40,000.00	45,000.00	5,000.00	
Notes Receivable	15,000.00	9,000.00		$6,000.00
Cash on Hand and in Bank	5,000.00	9,000.00	4,000.00	
Prepaid Insurance Premiums	1,000.00	1,200.00	200.00	
Prepaid Interest	500.00	200.00		300.00
	$126,500.00	$193,400.00	$73,200.00	$6,300.00
LESS--CURRENT LIABILITIES:				
Bank Loans	$ 45,000.00	$ 60,000.00	$15,000.00	
Trade Creditors, etc.	17,000.00	29,000.00	12,000.00	
Total Current Liabilities	$ 62,000.00	$ 89,000.00	$27,000.00	
BALANCE--Working Capital	$ 64,500.00	$104,400.00		
Net Increase (as above)				$39,900.00
			$46,200.00	$46,200.00

Solution to Problem 36 Exhibit I

A AND B
BALANCE SHEET, JUNE 30, 1919

ASSETS

CURRENT ASSETS:			
Cash		$10,035.00	
Accounts Receivable	$48,500.00		
LESS--Reserve for Bad Debts and Discounts	4,850.00	43,650.00	
Merchandise Inventory		19,000.00	$ 72,685.00
CAPITAL ASSETS:			
Plant, Tools, and Equipment	$37,000.00		
LESS--Reserve for Depreciation	1,850.00	$35,150.00	
Leasehold	$11,250.00		
LESS--Amount charged off	1,687.50	9,562.50	44,712.50
GOOD-WILL			33,613.89
			$151,011.39

LIABILITIES AND NET WORTH

CURRENT LIABILITIES:		
Accounts Payable	$46,975.00	
Due to C	57,088.06	$104,063.06
NET WORTH:		
A--Capital Account	$23,474.17	
B--Capital Account	23,474.16	46,948.33
		$151,011.39

A, B, AND C Exhibit II
STATEMENT OF PROFITS AND INCOME
FOR YEAR ENDING JUNE 30, 1919

MERCHANDISE SALES		$137,970.00
Cost of Sales (Exhibit III)		91,017.50
GROSS PROFIT ON SALES		$ 46,952.50
DEDUCT--GENERAL EXPENSES:		
General Expense	$3,900.00	
Provision for Bad Debts	4,850.00	8,750.00
NET PROFIT FROM OPERATIONS		$ 38,202.50
ADD--Inventory Reserve at July 1, 1918, written back		13,470.00
SURPLUS NET PROFIT for year		$ 51,672.50

Exhibit III

A, B, AND C
STATEMENT OF COST OF GOODS SOLD
FOR YEAR ENDING JUNE 30, 1919

Inventory as at July 1, 1918		$ 25,470.00
Purchases		69,510.00
Wages		11,500.00
Depreciation on:		
Plant, Tools, and Equipment	$1,850.00	
Leasehold	1,687.50	3,537.50
		$110,017.50
DEDUCT--Inventory as at June 30, 1919		19,000.00
COST OF GOODS SOLD (Exhibit II)		$ 91,017.50

ACCOUNT WITH RETIRING PARTNER

Balance as at June 30, 1919, before inclusion of allowance in respect of Good-Will and exclusive of drawings		$20,000.00
ADD--Two years' purchase of Good-Will as per statement below	$33,613.89	
Proportion of Surplus Net Profits for the year ending June 30, 1919	17,224.17	50,838.06
		$70,838.06
DEDUCT--Withdrawals		13,750.00
Balance at June 30, 1919, per adjusted Balance Sheet		$57,088.06

STATEMENT SHOWING METHOD OF DETERMINING GOOD-WILL

PROFITS FOR YEAR ENDING JUNE 30:		
1917	$44,540.00	
1918	55,050.00	
1919	51,772.50	$151,362.50
Equivalent to AN ANNUAL AVERAGE OF		$ 50,420.83
BASIS OF TWO YEARS' PURCHASE equals		$100,841.66
Of which C's share is equal to 1/3, or		$ 33,613.89

Comments on Problem 36

1. The inventory reserve of $13,470 had been created out of the profits of some one of the three years ending June 30, 1919; and since it is no longer required, is a credit to the Profit and Loss account of that period.

ANSWERS TO QUESTIONS

Answer to Question 91--An audit may be said to be such an examination of the books, accounts, and vouchers of a business as shall enable the auditor to satisfy himself as to whether or not the balance sheet and relative statement of profits and income are properly drawn up, so as to exhibit a true and correct view of the state of the affairs of the business at the closing date and the results from operations for the period under review, according to the best of his information and the explanations given to him and as shown by the books; and if not, in what respect they are untrue or incorrect.

Answer to Question 92--

(a) The objects of an audit may be said to be:

1. To ascertain the actual financial condition and earnings of an enterprise for:
   a) Its proprietors (individual, partners, or stockholders)
   b) Its executives (managers, officers, or directors)
   c) Bankers or investors who have purchased securities or loaned funds or contemplate doing so

2. Detection of fraud through:
   a) Misappropriation of moneys or goods by employees
   b) Manipulation of accounts so as to alter the financial results for the year

3. Detection of errors involving:
   a) Errors of principle
   b) Clerical errors
   c) Errors of omission
   d) Errors of commission
   e) Offsetting errors

(b) Some of the advantages derived from an audit, aside from those which obviously follow the objects enumerated in (a) are:

1. The condition of the business is accurately stated by an outside person and the result is sometimes a revelation to those who believed they were familiar with every detail of the business.

2. Bank loans may be more easily obtained, as the lender has greater confidence in the financial conditions set out and the earnings from operations for the fiscal period.

3. Facilitates the sale of a business in that the prospective purchaser insists upon a correct statement of facts before he will complete the transaction.

4. Where bonds have been issued, the trustee requires a periodical audit to assure himself that the covenants in the trust deed are being properly carried out.

5. In case of partnerships, an audit assures the proper carrying out of the stipulations contained in the partnership agreement and consequently avoids subsequent disputes.

6. In case of fire loss, certified accounts are of assistance in effecting an adequate settlement.
7. Is generally required by company bonding employees, and in any case reduces the cost of such bonds.
8. Where the accounts are published for the benefit of the stockholders, the auditor's certificate is the sole means available whereby the stockholders may assure themselves that the accounts as presented by the directors are in fact true accounts.
9. When fair rates are to be decided upon, it is to the advantage of the public service corporation to present audited accounts so as to assure the public that the earnings stated are in fact the true earnings.
10. Deterrent and moral effect of an audit.

Answer to Question 93--It is not the business of an auditor to balance the books, and he must take care to relieve himself of any responsibility for errors in balancing. Frequently the auditor is requested to balance the accounts, but if he does this work, it is in his capacity as accountant, and not as auditor, and should be subject to a separate arrangement.

In order to discover an error in a trial balance, if asked to do so, the first thing an auditor would do is to ascertain whether the customers and creditors ledgers have been separately proved and if so whether the difference on the books is represented by the difference on either the customers or creditors ledgers. Assuming these to have been agreed, the difference must arise in the general ledger, and the trial balance should be checked and footed. It should be seen that the balances at the commencement of the period in these ledgers are brought down, as frequently outstandings brought forward from one period to another are overlooked.

If the error is capable of being interpreted as a misposting, all items of that amount should be checked. Should the error not then be discovered, the whole of the postings, footings, and forwarding figures must be checked.

Assuming the general trial balance to be correct, but the difference to reside in either the customers or creditors ledgers, the balances of these ledgers must be checked and the trial balance footed.

If the difference still remains undiscovered the total accounts must then be proved. The fact that the inclusion of the balances on them causes the general trial balance to agree will not of itself prove the accuracy of the total accounts, since if the footings of the subsidiary books, such as the sales record, are erroneous, a compensating error will have been made, the total to the credit of Sales, and to the debit of Customers Ledger account being incorrect. The general trial balance, therefore, will not be affected, and the Customers Ledger controlling account will not agree with the customers ledger balances.

The total accounts having been proved to be correct by checking all footings and forwarding figures in the subsidiary books, and the error not having been discovered by this or any other method, an analysis of the ledgers must be resorted to, the totals of the analysis being proved with the totals of the subsidiary books.

The foregoing outline is necessarily limited. The exact procedure in any particular case must of course depend largely on the nature of the business and the character of the accounting system.

Answer to Question 94--The work involved in an audit is of a critical nature, and comprises an examination of the books and accounts for the purpose of ascertaining whether the balance sheet and relative statement of profits and income are properly drawn up. All other work in connection with the accounts, such as the drafting and preparation of the final accounts, balancing of books, writing up books, etc., is accountancy work, and does not form part of the duties of an auditor. In short, auditing is the analytical, as practical accounting is the constructive branch of accountancy.

If instructed by a private firm to perform accountancy work, the client's requirements should be formulated in writing and the accountant should take care that the limits of his responsibilities are clearly defined.

Answer to Question 95--The legal responsibilities of an auditor are stated by Montgomery to be as follows:

"SUMMARY OF DECISIONS--

"Based upon the English decisions and upon the principles of the common law in force in the United States, the professional auditor's legal duties and liabilities may be summarized as follows:

"1. Anyone who holds himself out as skilled in a profession is charged with a higher degree of responsibility than one who is inexperienced and who does not seek professional work. Acting in a professional capacity, an auditor must do more than ascertain the mere arithmetical accuracy of the accounts. If the accounts do not represent the true financial position of the undertaking under examination, and if that fact is apparent or can reasonably be deduced from the face of the accounts themselves, then the auditor is under a legal obligation to discover and disclose the true state of affairs.

"2. The auditor, however, is not an insurer unless he assumes such a position. If he uses reasonable care--the care of an ordinarily skilful auditor, under the circumstances of the case--no legal responsibility is incurred by him.

"3. Reasonable care has been stated by the courts to depend upon the circumstances of each case. Where there is no reasonable ground for suspicion of fraud, it is not necessary to take as many precautions as are requisite where the auditor is led to believe that irregularities exist.

"4. Ordinarily what is known as a 'test and scrutiny' audit is sufficient, but in every case there must be a careful survey of the assets, the liabilities, the income, and the expenses, in order that the auditor may satisfy himself that the assets and the income are accounted for, and that the liabilities and expenses are properly supported. The auditor need not verify every item, but he must not omit any part of an audit which the custom of the profession decrees should be covered.

"5. The experience of other practitioners and access to recognized authorities on the subject being available, a defense of ignorance as to what is re-

quired in an audit will not save an auditor from responsibility for failure to follow settled rules of practice.

"6. The general rule of the common law, that all men are considered honest until proved dishonest, may be observed by an auditor with respect to the staff of the client; but he is charged with an exceptional degree of diligence in recognizing indications of dishonesty on the part of those who occupy responsible positions.

"7. An auditor's relation to his client is in the highest degree confidential, and he has no legal right to communicate with third parties (debtors or creditors) unless he secures permission to do so. If his position as auditor becomes incompatible with honesty, he may withdraw at any time, but he is not at liberty to disclose to outsiders the cause of his withdrawal.

"8. In communicating with his client, however, the auditor is bound to disclose information, of whatever nature it may be, which is of value to the client, and any suppression of material facts is at his own risk.

"9. In the event of loss through an auditor's negligence, the client may recover damages against him. The measure of damages is the amount which the client or other interested party has lost as a legal consequence of the auditor's failure to perform his duty properly."

REFERENCES:
Montgomery, pages 71-84
Wildman, pages 42-43; 135-142

F. L. Barnes & Co.

Accounts Receivable 4

Trial Balance subsidiary ledger (1)

as of December 31, 1918.

Name	Amount	30 days	60 days	90 days	over 90 days
Customers—					
A. G. Adamson	$60.00	$60.00			
(1) A. G. Allen	97.00	47.00		$50.00	
L. Arthur & Son	115.00	115.00			
(4) F. M. Ames	120.00		$60.00	60.00	
Dwight Anderson	96.00	96.00			
D. W. Annick	96.00		96.00		
Frank L. Bauer	79.00	79.00			
(5) Morton Barnes	78.00		38.00		5/3/18 $40.00
G. Barry	112.00	50.00	62.00		
Miss Lottie Berg	111.00	111.00			
Mrs. M. G. Betram	111.00	111.00			
L. G. Bonner	96.00	96.00			
Mrs. Fannie Bowe	78.00		78.00		
(2) A. M. Carlson	60.00				7/26/18 60.00
Geo. Cartwright	111.00		111.00		
(4) Sam Cazorki	78.00			78.00	
Mary Cemal	78.00	78.00			
(1) R. S. Cinder	96.00			96.00	
M. L. Conner	97.50	1.50	96.00		
Ph. Culbertson	27.22	27.22			
Geo. Davis' Sons	98.45	96.00	2.45		
Michael Doud	67.45	7.45	60.00		
(3) Mary Doud	120.00				7/15/18 120.00
Peter Early	78.80	78.80			
H. M. Eustis	46.00		46.00		
Mrs. Lottie Frank	20.50	20.50			
(1) Geo. Friedman Co.	1,286.90	989.40	207.00	90.50	
M. T. Fumasoli	78.00	78.00			
Sam Gerhardi	96.00		96.00		
Leo. George	15.40		15.40		
D. S. Hand	111.00	111.00			
Frank Hulbert	111.50	111.50			
Dr. Geo. W. Hume	96.00	96.00			
Forrest James	96.00		96.00		
Ernest Jansen	47.50	47.00	.50		
Johnson Bros.	542.60	496.00	46.60		
James Johnson	67.34	60.00	7.34		
Lamie Jones	79.80	79.80			
Ole Kirstner	78.00	78.00			
Palmer Knut	96.00	48.00	48.00		
James Larsen	60.00	60.00			
Forwarded—					

F. L. Barnes & Co.

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Accounts Receivable ②

		Amount	30 days	60 days	90 days		over 90 days
	Forwarded —						
	Nance Furniture Co.	$ 1,333.65	$ 1,100.52	$ 233.13			
	K. H. Numeral	68.60	68.60				
	N. M. Nundt	94.50	78.00	16.50			
	C. E. Owsley	22.20		22.20			
③	Geo. Palmer & Co	457.00			$ 425.50	8/4/18	$ 31.50
	Parker Sales Co.	330.01	330.01				
	A. E. Parker	79.40	79.40				
	Nick Ramsay	113.50	110.00	3.50			
	Rev. Norwald Rogers	120.00	120.00				
	Miss E. Roehm	79.00	79.00				
	Loren Runner	96.50	48.00	48.50			
	Minnie Sales	111.00	111.00				
①	Fannie Sulzer	27.50			27.50		
	A. E. Thomas & Co	1,027.50	903.50		111.45	9/25/18	12.55
	Parker, Thoman & Hand	16.75	16.75				
	Geo. S. Williams	111.00	111.00				
	N. W. Wilkinson	78.00		78.00			
②	Fred Wimmer	96.00			96.00		
	A. O. Wodanski	96.00	96.00				
	G. L. & M. L. Wood	60.25	60.25				
	Geo. W. Wright & Co.	1,287.20	1,087.20	200.00			
	Sam. Wyman	27.70	27.70				
		$ 10,823.22	7,756.10	$ 1,768.12	$ 1,034.95		$ 264.05
	%	100.00 %	71.66 %	16.34 %	9.56 %		2.44 %

① Paid in 1919
② Credits for Returns & Allowances to be put through.
③ Bankrupt and not collectible.
④ Doubtful

All accounts above examined and reviewed with Myron T. Barnes Credit Manager. In December 1918, sixteen old accounts were written off to Bad Debts accounts.

Mary Doud went through bankruptcy proceedings in Sept. 1918 — No dividends.

Geo. Palmer & Co was liquidated through bankruptcy and no assets found for unsecured creditors.

Credits for R. & A.	—	$ 196.00
Bad accounts	—	577.00
Doubtful — $198.00 ½	—	99.00
		$ 872.00

J. L. Barnes & Co.
Instalment Accounts Receivable
Trial Balance subsidiary Ledger
as of December 31, 1918

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(1)

Date	Name	Address	Amount	Past Due	January	February	March	April	Remarks
Dec 15 1918	Emma B Addison	Chicago	$ 48.00	$	$ 16.00	$ 16.00	$ 16.00	$	
Nov 29	E M Ahern	Fox Lake, Wis	37.00		18.50	18.50			
Nov 23	J. [illegible]	Chicago	37.00		18.50	18.50			
(2) Sept 6	Chas. Barron	[illegible] Ill	26.00	26.00					Letter of 1/13 promised to pay before Feb 15th
(1) July 5	W. L. Briggs	Chicago	12.50	12.50					Bad - claims this as allowance on account of shipment of wrong style.
Oct 8	N Brown	Chicago	16.00		16.00				
Nov 4	J. Campbell	Chicago	26.00		13.00	13.00			
Dec 6	George Cheney	Chicago	43.52		13.00	13.00	17.52		
Nov 5	Henry Connell	Lemont Ill.	37.00		18.50	18.50			
Oct 16	John D. Core	Willow Spring Ill.	16.84		16.84				
(1) Dec 17	Wm J Dailey	Chicago	111.00	55.50	18.50	18.50	18.50		Paid $111.00 1/13/19
Nov 6	J. Denny	Chicago	32.00		16.00	16.00			
Nov 7	George Elton	Long Lake Ill.	40.00		20.00	20.00			
Oct 22	W. Evans	Chicago	10.21		10.21				
Oct 18	J. Fagan	Desplaines, Ill.	19.25		19.25				
Dec 4	M. K. Farrell	Elgin, Ill.	68.50	8.50	20.00	20.00	20.00		
Nov 26	L. Fine	Argo, Ill	32.00		16.00	16.00			
Nov 5	G. Fleming	Chicago	20.00		10.00	10.00			
(2) May 9	Frank Fox	Chicago	16.00	16.00					Bad a/c - moved & cannot locate
(1) Aug 6	Helen Gibson	Summit Ill.	40.00	40.00					Paid 1/15/19
Dec 5	John Gill	Chicago	120.00		60.00	20.00	20.00	20.00	Post-dated 1/15/19
Oct 18	M. Gold	Chicago	18.50		18.50				
Dec 15	R. Hale	Oak Park Ill.	111.00		55.50	18.50	18.50	18.50	" " " "
Dec 12	Leo Hoberg	Evanston Ill.	48.00		16.00	16.00	16.00		
Nov 27	F. Hyman	Chicago	37.00		18.50	18.50			
Oct 4	C L Ibsen	Waukegan, Ill.	18.50		18.50				
Dec 12	G. Iverson	Racine, Wisc.	78.00		39.00	13.00	13.00	13.00	Post-dated 1/15/19
Nov 18	E Johnson	Chicago	26.00		13.00	13.00			
Nov 19	Wm Jung	Riverside Ill	20.00		10.00	10.00			
Oct 6	Jos. Kaster	Chicago	16.00		16.00				Interned in Oct 1918 - Write off
(2) Aug 4	Max Katz	Riverdale, Ill.	24.57	24.57					Died, July 1918 no estate " "
(3) April 14	W. Kelley	Chicago	15.22	15.22					
Nov 12	Geo Lamb	Chicago	32.00		16.00	16.00			
Dec 19	Ed Mack	Chicago	55.50		18.50	18.50	18.50		
Oct 18	J Manning	Three Lakes Wis.	18.50		18.50				
Dec 17	M. Nystrom	Chicago	96.00		48.00	16.00	16.00	16.00	Post-dated 1/17/19
(3) July 5	W O'Brien	Chicago	10.00	10.00					Bad - Write-off
Nov 7	S. C. Osborn	Great Lakes Ill.	32.00		16.00	16.00			
Nov 17	Chas Page	Rockford Ill	36.50	4.50	16.00	16.00			
Nov 18	Leo Peterson	Indianapolis, Ind.	37.89		16.00	21.89			
Dec 4	H. Ries	Nitro, W V	48.00		16.00	16.00	16.00		
(2) Oct 9	Louis Rose	Chicago	18.50			18.50			Extended to Feb. by request.
	Forwarded —		1606.50	212.79	690.30	445.89	190.02	67.50	

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(2)

Date	Name	Address	Amount	Past Due	January	February	March	April	Remarks
	Forwarded		$ 1606.50	$ 212.79	$ 690.30	$ 145.89	$ 190.02	$ 67.50	
(3) June 15	Max Salberg	Cleveland, Ohio	60.00	60.00					Bad a/c - Write off
Oct. 11	Geo. Thompson	Chicago	13.00		13.00				
Dec. 15	Robert Uber	St. Louis, Mo.	39.00		13.00	13.00	13.00		
Nov. 5	J. Vaughn	Boston, Mass.	40.00		20.00	20.00			
Nov. 4	Geo. Vogel	New York City	37.00		18.50	18.50			
(2) May 9	A. Worz	Chicago	55.50	55.50					Doubtful: cabinet damaged in delivery refused to pay.
Oct. 15	Geo. White	Chicago	15.00		15.00				
Dec. 9	L. Wolcott	La Grange, Ill.	132.10		72.10	20.00	20.00	20.00	Post-dated 1/1/19
Dec. 26	W. Young	Brookfield, Ill.	60.00		20.00	20.00	20.00		
Nov. 12	G. Yinger	Chicago	26.00		13.00	13.00			
Dec. 8	W. Yale	Chicago	39.00		13.00	13.00	13.00		
Oct. 18	Fred Yacker	Wheeling, Ill.	15.50		15.50				
(1) April 17	John Yang	Chicago	5.00	5.00					Paid 1/12/19
(4) Nov. 13	H. Zimmerman	Dixon, Ill.	43.20	3.20	20.00	20.00			Unpaid at 2/5/19 Doubtful
(4) Oct. 6	A. Zio	Chicago	10.00		10.00				" " " "
			$ 2196.80	$ 336.49	$ 933.40	$ 583.39	$ 256.02	$ 87.50	

No notes or mortgages taken as security.

(1) Paid in 1919	
(2) Credits for Returns and Allowances	$ 68.00
(3) Bad accounts	125.79
(4) Doubtful $97.70 Provide for entire amount	97.70
	$ 291.49

F. L. Barnes & Co.
Abstract of Notes Receivable Register 6
as of December 31, 1918

Dated.	To	Interest	Due	Amount	Remarks
1-14-18	Ephros & Stillwater Chgo.	6%	On Demand	$ 468.72	Is being paid off by $50 monthly
12-2-18	James Q. Allison "	7%	1-2-19	50.00	Paid 1/3/19
12-15-18	Improved Kitchen Cabinet Co	6%	2-15-19	873.50	Balance a/c 12/15
10-6-18	Timothy F. Manning 3 Lakes, Wis.	6%	12-24-18	354.87	Paid 2/1/19
12-1-18	Eames & Dudley, Georgetown, Pa	$6\frac{1}{2}$%	1-2-19	231.00	Paid 1/27/19
				$ 1,978.09	
	Interest Accrued				
			$ 27.03		
			.27		
			2.18		
			4.97		
			1.16		
			$ 35.61		

F. L. Barnes & Co.

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Reserve for Bad Debts.

Date	Description	Detail	Amount
	Balance Jan. 1, 1918		$ 1,028.90
	Amounts previously written off, collected during year =		
1/12/18	Al Johnson	$ 15.00	
3/8	F. L. Saunders	200.00	
12/9	M. W. Somers	156.00	371.00
			$ 1,399.90
	Less – Written off during year		
7/1	Ed Jones	$ 79.40	
7/1	L. L. Arthur	2.00	
7/1	Max Sorenson	.22	
7/1	James P. Glaughtry	16.70	
12/15	L. M. Hubbard	4.80	
12/15	Alex Mardout	9.00	
12/15	Minnie Gernster	147.50	
12/15	F. G. Kaul	6.00	
12/15	Saul Goldberg	212.00	
12/15	Howard E. Sand	25.00	
12/15	G. E. Montgomery	55.00	
12/15	E. O. Spread	87.50	
12/15	Sam F. Silver	41.40	
12/15	D. B. Forward	7.00	
12/15	Daniel True	.20	
12/15	F. O. Elliot	.03	
12/15	Geo. P. Held	.12	
12/15	Parker Lamb	108.00	
12/15	Michael Court	48.80	
12/15	A. F. Foster	47.07	897.50
	Balance Dec 31-1918		$ 502.40

The accounts ascertained to be bad as of Dec. 31, 1918 but not charged to above reserve have been carried to P & L (see Adj J/E #5) it being the opinion that the above balance of $ 502.40 should be carried forward to 1919 to provide for possible losses on 1918 accounts in addition to the above. Those ascertained to be doubtful = $ 295.70 – Feb. 6, 1919

COMPLETE ACCOUNTING COURSE--PART II

Lecture 19

INVENTORIES

Problem 41

The operations of the Reliable Machine Co. for the month of April consisted of the following:

1. Materials used $39,083.27, productive labor $38,092.78, and general foundry expenses $19,027.83 for the month of March, these expenditures representing the cost of producing 1,200,000 pounds of castings during that month.

2. Castings produced on the following orders:

ORDER NO.	POUNDS
196	304,000
198	100,000
203	98,000
206	350,000
209	175,000

   Charge each of these orders with the cost of the castings based upon the average cost per pound for the month of March.

3. General stores issued:

ORDER NO.	VALUE
196	$11,088.12
198	9,001.33
201	12,081.32
207	11,091.33
208	31,083.27
212	13,827.23
215	9,038.11

4. Productive labor:

	MACHINE SHOP	
ORDER NO.	Hours	Amount
196	11,000	$4,608.07
198	10,000	3,812.08
201	13,000	5,708.91
207	14,000	6,103.27
208	52,000	18,081.33
212	16,000	6,308.32
215	10,500	4,108.27

5. General factory expenses $38,083.11. Distribute the factory expenses against the various orders upon the basis of the machine hours.

6. The following orders were shipped:

ORDER NO.	SELLING PRICE
196	$35,000.00
198	21,000.00
206	35,000.00
209	20,000.00

Prepare all of the necessary entries in respect of the foregoing.

Problem 42

The John Anson Co. is a corporation engaged in the commission business and deals exclusively in butter, all of which is received on consignment. Their balance sheet on July 1, 1919, follows:

JOHN ANSON COMPANY
BALANCE SHEET, JULY 1, 1919

ASSETS

CURRENT ASSETS:		
Cash	$8,747.61	
Accounts Receivable (Less--Reserve for Discounts, $150)	8,965.42	
Merchandise on Hand	4,545.67	$22,258.70
PREPAID INSURANCE		889.61
FURNITURE AND FIXTURES	$3,745.00	
Less--Reserve for Depreciation	2,400.00	1,345.00
		$24,493.31

LIABILITIES

CURRENT LIABILITIES:		
Accounts Payable for:		
Freight	$ 15.50	
Cartage	26.72	
Miscellaneous Charges	15.00	
General Expenses	18.71	
Accrued Taxes	221.74	
Sales on Consignments not closed out (less--Freight $87.45, Cartage $4.16, and Drafts $961.75)	6,420.82	$ 6,718.49

NET WORTH:		
Capital Stock		10,000.00
Surplus--Balance June 1, 1919	$5,346.68	
Profits for June (including gross profit of $1,140.71 on consignments partially sold)	2,428.14	7,774.82
		$24,493.31

Three books of account are kept: cash book, sales book, and account sales register. In addition, a memorandum account is opened up with each consignment on a separate sheet; when advances (drafts or expenses) or sales are made the amounts are carried to the consignment sheet, and when the consignment is paid and thus closed out the sheet is filed away after having served as the basis for preparing an account sales. There are only a few dozen credit customers, all of whom settle their accounts weekly; hence no ledgers are kept. The term "merchandise" as used here refers to certain consignments or portions thereof which the business pays for on its own behalf and sells to its customers in the usual way. The cash book, sales book, and account sales register are columnar in form and admit of the following information for the month of July, 1919;

CASH BOOK

CASH RECEIPTS

Cash Balance, July 1, 1919		$ 8,747.61
Customers' Accounts	$28,673.92	
Discounts Allowed	768.50	27,905.42
Cash Sales--Merchandise		311.42
Cash Sales--Consignments		3,020.23
Interest on Bank Balance, July		10.05
Cash in Exchange for checks issued (per contra)		341.00
		$40,335.73

CASH DISBURSEMENTS

Charged to Consignments:	
Freight	$ 540.60
Cartage	112.84
Storage	57.50
Miscellaneous	157.98
Drafts	9,749.23
Net Proceeds	17,337.75
Selling and General Expenses:	
Clerks' Salaries	475.00
Office Salaries	330.00
Rent	125.00
Postage and Stationery	53.67
Insurance	110.00
General Expenses	74.86
Checks in exchange for cash (per contra)	341.00
Cash Balance, July 31, 1919	10,870.30
	$40,335.73

SALES BOOK
(Does not include Cash Sales)

Merchandise Sales	$ 5,337.89
Consignment Sales	30,014.55

ACCOUNT SALES REGISTER

DEBITS		CREDITS	
Freight	$ 436.82	Merchandise Purchases	$ 5,463.81
Cartage	114.45	Consignment Sales	24,674.25
Storage	57.50		
Miscellaneous	142.98		
Drafts	9,462.47		
Net Proceeds	17,337.75		
Gross Profit (Commission)	2,586.09		
	$30,138.06		$30,138.06

An examination of the sheets on the consignments not yet closed out yielded the following summary:

DEBITS		CREDITS	
Freight	$ 190.55	Sales (of which it is estimated $2,111.16 is gross profit)	$16,975.42
Cartage	13.43		
Drafts	1,248.51		

There are accounts payable on July 31 on account of: freight, $14.82; cartage, $37.60; general expense, $44.66; additional taxes accrued during July, $35.16. It is expected that customers will take advantage of discount to the extent of $275; additional depreciation has accrued on furniture and fixtures of $100; insurance has expired amounting to $42.78. The merchandise on hand at July 31 is $5,473.82.

From the above information prepare a detailed statement of profit and loss for the month of July and a balance sheet as of July 31, 1919.

QUESTIONS

Question 106--Outline the procedure you would follow if called upon to audit the raw material inventory of an automobile manufacturing company.

Question 107--In auditing the accounts of a steel products manufacturing company would you consider it proper under any circumstances to allow the Profit and Loss account to be credited with profit on uncompleted work?

Question 108--What steps would an auditor take in the verification of inventories of finished products?

<u>Question</u> <u>109</u>--Where an auditor is engaged in verifying the finished product inventory of a bicycle manufacturer, to what extent is he justified in relying upon the cost records to determine the cost of such inventories?

<u>Question</u> <u>110</u>--What do you understand by the:
(a) Gross profit test
(b) Comparative inventory test
State how these tests would be applied in a manufacturing concern.

<u>Solution to Problem 37</u> <u>Exhibit I</u>

A B CO.
BALANCE SHEET, JANUARY 1, 1919

ASSETS

CAPITAL ASSETS:				
Plant				$ 250,000.00
CURRENT ASSETS:				
Inventory (after deducting reserve for discounts of $16,000)			$304,000.00	
Accounts Receivable		$400,000.00		
DEDUCT--				
Bad Debt Reserve	$ 4,000.00			
Reserve for Discounts	16,000.00	20,000.00	380,000.00	
Notes Receivable			30,000.00	
Cash			50,100.00	764,100.00
DEFERRED CHARGES:				
Prepaid Interest				18,000.00
				$1,032,100.00

LIABILITIES

CAPITAL STOCK ISSUED AND OUTSTANDING		$ 225,000.00
CURRENT LIABILITIES:		
Notes Payable	$600,000.00	
Accounts Payable (after deducting reserve for discounts of $4,500)	85,500.00	685,500.00
SURPLUS:		
Balance, as at January 1, 1918	$ 55,000.00	
ADD--Surplus Net Profits, as per statement of Profits and Income (Exhibit II) for year ending January 1, 1919	66,600.00	121,600.00
		$1,032,100.00

Exhibit II

A B CO.
STATEMENT OF PROFITS AND INCOME
YEAR ENDING JANUARY 1, 1919

SALES		$1,500,000.00
DEDUCT--Returns	$100,000.00	
Discounts	55,900.00	155,900.00
NET PROCEEDS FROM SALES		$1,344,100.00
DEDUCT--Cost of Sales (Exhibit III)		1,064,000.00
BALANCE--GROSS PROFITS		$ 280,100.00
DEDUCT--GENERAL AND ADMINISTRATIVE EXPENSES:		
Salaries	$ 20,000.00	
Taxes	5,000.00	
Bad Debts	3,000.00	
Expenses	156,000.00	184,000.00
BALANCE--NET PROFITS FROM OPERATION		$ 96,100.00
DEDUCT--Interest paid		30,500.00
		$ 65,600.00
ADD--Miscellaneous Income, pertaining to prior year's operations:		
Credit Insurance on 1910 losses		1,000.00
SURPLUS NET PROFITS carried to Surplus Account (Exhibit I)		$ 66,600.00

Exhibit III

A B CO.
STATEMENT OF COST OF SALES
YEAR ENDING JANUARY 1, 1919

INVENTORY AT JANUARY 1, 1918 (Less--Reserve of $12,000 for discounts)			$ 228,000.00
MERCHANDISE PURCHASES		$1,250,000.00	
DEDUCT--Returns	$50,000.00		
Discounts taken	60,000.00	110,000.00	1,140,000.00
			$1,368,000.00
DEDUCT--Inventory at January 1, 1919 (Less--Reserve of $16,000 for discounts)			304,000.00
BALANCE--COST OF SALES (Exhibit II)			$1,064,000.00

NOTE--Adjusting journal entries are not called for by the problem, but the following are submitted in order to enable the students better to understand the effect of the adjustments:

ADJUSTING ENTRIES

(1)		
Reserve for Discount Accounts Payable	$ 500.00	
To--Purchase Discounts		$ 500.00
To increase reserve for discounts to 5% on outstanding accounts,		
(2)		
Discounts Allowed Customers	4,000.00	
To--Reserve for Discount Accounts Receivable		4,000.00
To increase reserve for discounts to 4% of outstanding Accounts Receivable.		
(3)		
Bad Debts charged off 1917 collected	500.00	
To--Reserve for Bad Debts		500.00
To transfer first-named account.		
(4)		
Reserve for Bad Debts	2,500.00	
To--Bad Debts charged off to January 1, 1919		2,500.00
To transfer bad debts charged off to reserve.		
(5)		
Bad Debts	3,000.00	
To--Reserve for Bad Debts		3,000.00
Increase reserve to 1% of gross Accounts Receivable at January 1, 1919.		
(6)		
Cost of Sales Account	4,000.00	
To--Reserve for Discount Merchandise Inventory		4,000.00
To close latter account.		
(7)		
Interest	12,500.00	
To--Prepaid Interest		12,500.00
To close latter account, interest expiring July 1, 1918.		
(8)		
Prepaid Interest	18,000.00	
To--Interest		18,000.00
To set up prepaid interest at December 31, 1919.		

Solution to Problem 38

Exhibit I

A--PROPRIETOR
BALANCE SHEET, DECEMBER 31, 1917

ASSETS			LIABILITIES AND DEFICIT		
CURRENT ASSETS:			LOANS (subject to accrued interest not provided for)		
Inventory of Merchandise	$25,000		John Smith	$30,000	
Accounts Receivable	5,000		Mary White	6,000	$36,000
Advances to Employees	2,000		ACCOUNTS PAYABLE		15,000
Cash on hand	1,300	$33,300			
			Total Liabilities		$51,000
FIXTURES (subject to accrued depreciation not provided for)		7,000	DEFICIT:		
			Balance at January 1, 1917	$ 2,700	
			Net Loss year ending December 31, 1917 (Exhibit II)	5,000	
			Drawings	3,000	*10,700
		$40,300			$40,300

* Red

NOTES--
(1) The Mary White item of $6,000 is presumably still unpaid.
(2) Advances to employees of $2,000 have been taken to be unpaid.

Exhibit II

A--PROPRIETOR
STATEMENT OF PROFITS AND INCOME
YEAR ENDING DECEMBER 31, 1917

SALES		$40,000.00
DEDUCT--COST OF GOODS SOLD:		
Merchandise Purchases	$50,000.00	
Less--Inventory December 31, 1917	25,000.00	25,000.00
BALANCE--GROSS PROFITS		$15,000.00
DEDUCT--EXPENSES		20,000.00
BALANCE--NET LOSS FOR YEAR		$ 5,000.00

ANSWERS TO QUESTIONS

Answer to Question 96--

(a) A balance sheet audit consists of such an examination of the books, accounts, and vouchers of a business as shall enable the auditor to satisfy himself as to whether or not the balance sheet is properly stated so as to exhibit a true and correct view of the financial condition of the business at a certain date. The general audit differs from the balance sheet audit in that the auditor must also satisfy himself as to whether or not the statement of profits and income is so drawn up as properly to set out the results from operation during the period under audit. The scope of a detailed audit would require in addition thereto a detailed check of vouchers, checks, postings, and footings.

(b) A cash audit consists of such an examination of the books, accounts, and vouchers of a business as shall enable the auditor to satisfy himself as to:

1. Whether all cash recorded as received has been accounted for by the receiving agents.
2. Whether all cash which should have been recorded as received has as a matter of fact been so recorded.
3. Whether all cash recorded as disbursed has been accounted for by the disbursing agents.
4. Whether all cash recorded as disbursed has been properly authorized.

Answer to Question 97--See Montgomery, pages 53-58.

Answer to Question 98--Yes, especially if the footing is the amount posted to the ledger. For instance, if the cash disbursements side has a column for expense, the total of which is posted to the debit of Expense account, the raising of the footing of this column would conceal a corresponding shortage in cash, and the same purpose could be attained by increasing the footing of the cash receipts column.

It is necessary to check the postings to see that the items in the ledger purporting to come from the cash book are in fact cash book entries, and not arbitrary entries made for the purpose of balancing the ledger, either because the bookkeeper is too lazy or incompetent to locate an error, or to conceal fraud.

Answer to Question 99--The following steps would be adopted in the verification in the cash balance given in the question:

1. A certificate would be obtained from the bank as to the bank balance of $5,610.
2. A B's check for $400, not deposited, would be traced into the pass book in the subsequent period to see that it actually cleared and was good.
3. The outstanding checks represented in the total of $2,500 would be verified. The auditor should be careful to note that the entries in respect thereof were entered in the cash book on or prior to the date of the cash verification.
4. The cash in drawer, amounting to $300, would be counted by the auditor, preferably at the close of business on the day of the verification.

Answer to Question 100--As part of the verification of bank balances it is necessary to trace the receipts, per cash book, with the deposits per pass book in order to insure that all receipts were deposited intact.

To illustrate the point, a cashier might be short \$500 in his accounts during the year and knowing that an audit is to be made as of a subsequent date, would make good this shortage, temporarily at least, by depositing the amount before the close of business on the last day of the period to be audited. On the first day of the succeeding period the amount could again be withdrawn by an appropriation of receipts for that day.

Thus the balance at the close of the period would agree with the cash book, while as a matter of fact there was a sum of \$500 misappropriated.

REFERENCES:

Montgomery, pages 84-99
Wildman, pages 108-119

F. L. Barnes & Co.

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Inventory Dec. 31, 1918
Raw Materials

Page	Particulars	Item No.	Cost	Market	Inventory Value
	Lumber-				
1-5	White Pine, Oak, Hemlock, etc. in Yard	1	$ 11,584.29	$ 10,758.28	$ 10,758.28
6-7	Ditto in factory not in work in Process	2	1,028.96	1,001.19	1,001.19
8-10	Lumber in Kiln	3	2,147.18	2,058.68	2,058.68
11	Beading	4	467.20	467.20	467.20
12	Veneer Stock	5	1,740.01	1,740.01	1,740.01
13	Mill Ends-Loaded in cars {P.L.&E. 10156 / M.C. 41041}	6	500.50	783.95	500.50
13	Mill Ends-in Yard	7	235.00	250.00	235.00
	Hardware & Fittings-				
14	Drawer Pulls	8	181.25	187.50	181.25
14	Glass	9	499.18	550.00	499.18
14-20	Miscellaneous-Castors, Screws, Putty, Nails	10	1,102.70	1,102.70	1,102.70
21	Varnishes	11	1,604.81	1,759.80	1,604.81
22-3	Paints	12	1,159.14	1,286.50	1,159.14
24	Flour Sifters	13	214.75	214.75	214.75
25-30	Slides and Screws	14	2,284.74	2,655.12	2,284.74
			$ 24,749.21	$ 24,815.18	$ 23,806.93

Footed pages 1-20 inclusive
Checked extensions on items of more than $25.00
Ascertained market prices from invoices nearest December 31st
and applied same to quantities on inventory sheets
Compared quantities shown by two groups of inventory takers
working independently.
Cost is average cost obtained by computing a new unit price whenever
a new lot is received, e.g.—

	Feet	Cost	Price Average	Cost	Extension
Balance White Pine on hand Dec. 18	124,750		38.71		4,828.92
Purchase Hirsc 12/18/18	17,000	37.50	38.56	637.50	5,466.42

F. L. Barnes & Co.

Inventory as of December 31, 1918.

Work in Process

Job Ticket Number	Job Ticket Date	Calling For Style	Calling For Amount	Material Requisitions Number	Material Requisitions Amount	Direct Labor Total Hours	Payroll Amount	Other Direct Charges Date	Other Direct Charges Ref.	Other Direct Charges Amount	Factory Overhead 82.45% of Production Labor	Total Cost at December 31, 1918	Average previous Cost Each	Average previous Cost Total	Remarks
18344	10/3/16	187 Special	50	P3543 P3590 P3541	$ 284.50 1,296.00 875.99	2046	$ 989.43	11-2-16	SJ 462	$ 25.42	$ 815.78	$ 4,287.12	$ 97.50	$ 4,875.00	See Note 1
69	12/1/16	180 Special	10	P8964 P9001	125.14 27.45	248	110.27	--		- -	90.92	353.78	45-	450.00	" " 2
19480	7/5/17	180	20	Q2780 Q2781	221.15 187.55	532	252.21	--		- -	207.95	868.86	45-	900.00	" " 3
20019	10/3/18	185	48	R7702 R7990	1,201.00 422.97	2022	1,004.53	10-3-18	JV 1827	124.90	828.23	3,581.63	88.50	4,248.00	
20	✓	183	48	R7701 R7703 R7847	246.05 498.40 1,002.25	1747	823.02	10-17-18	1925	32.95	678.58	3,281.35	75-	3,600.00	
31	10/16/18	187	36	R7802	469.01	35	16.65	--	--	- -	13.73	499.39	97.50	3,510.00	
3	✓	185 Special	1	R7806 R7800	12.40 35.89	8	3.60	--	--	- -	2.97	54.86	88.50	88.50	
4	✓	181	15	R7810 R7955	342.05 77.80	420	202.84	--	--	- -	167.24	789.93	60-	900.00	
9	10/21/18	181	12	R7888	120.08	95	40.52	--	--	- -	33.41	194.01	60-	720.00	
48	10/20/18	183	12	R8526 R8528	125.61 347.06	136	62.48	--	--	- -	51.51	586.66	75-	900.00	
51	12/23/18	185	50	R9783 R9792	1,349.60 451.20	2149	1,012.84	12-26-18	JV 2426	47.55	835.09	3,696.28	88.50	4,425.00	
2	✓	185	50	R9784 R9793	1,344.60 451.20	2147	1,013.96	12-26-18	2426	47.54	836.01	3,698.31	88.50	4,425.00	
3	✓	185	50	R9785 R9794	1,349.60 426.32	384	171.00	--	--	- -	140.99	2,087.91	88.50	4,425.00	
4	✓	185	42	R9786 R9795	1,133.66 331.11	12	5.76	--	--	- -	4.75	1,475.28	88.50	3,717.00	
5	12/26/18	187	12	R9877	424.20	--	- -	12/30/18	JV 2509	82.15	- -	506.35	97.50	1,170.00	
8	12/30/18	187	48	R9902	1,591.87	--	- -	--	--	- -	- -	1,591.87	97.50	4,680.00	
					$ 16,776.81	11,981	$ 5,709.11			$ 360.51	$ 4,707.16	$ 27,553.59		$ 43,033.50	
							Estimated Cost to Complete					$ 20,000.00			

Note 1 - Style 187 Special - These specials were ordered Oct. 25, 1916 by selling agent and were to be specially equipped for use in an apartment hotel. With slight alterations they could be converted into 187 Regulars at a cost of about $1,000.00

Note 2 - Style 180 - Special - Same as above - conversion cost $300.00 Both these specials were carried at full value in 1917 owing to belief that selling agent had verbally agreed to dispose of them. However, the management is desirous of disposing of them and does not care to wait until they are disposed of in present form. They are now being altered (Feb. 3-1919).

Note 3 - Style 180 - No market for this style. Reserve was provided in 1917 See Inventory Finished Stock

Average Costs now about 10% higher than amounts shown above in next to last column.

F. L. Barnes & Co

Inventory as of December 31, 1918 — 10

Finished Stock

Page	Style	Number	Actual Cost	Average Cost	Destination		
	In Factory awaiting shipment to warehouse, etc.						
31	181	34	$ 2,165.42	2,040.00	Warehouse		
	185	11	1,012.88	973.50	J. M. Karsten, Delavan, Ill.		
	187	2	205.49	195.00	Warehouse		
	In Warehouse						
32	180	38	1,694.80	1,710.00	On hand since 7/1/16		
	181	216	13,124.03	12,960.00	Manufactured 1918 – 4 in 1917		
	183	326	26,742.89	24,450.00	"	"	
	187	189	19,105.46	18,427.50	"	"	
					Location		
	In Display Rooms				Chgo.	N.Y.	Good Housekeeping
33	180	1	43.20	45.00	1	0	0
	181	5	311.45	300.00	2	2	1
	183	5	378.20	375.00	3	2	0
	185	5	430.15	442.50	3	1	1
	187	4	403.87	390.00	1	2	1
	Delivered to C. J. Ry. December 30-31-1918 B/L's and Invoices not prepared until 1/2/19 — Improved Kitchen Cabinet Co —						
34 to 36	183	44	3,418.96		Shipments are made as cars are available, and merchandise is held by C. J. Ry until final shipping instructions are received. Invoices in this case are all dated Jan. 2, 1919. About 75 cabinets in hands of C. J. Ry. 12/31/17		
	187	37	3,766.80				
	Miscellaneous						
	181	3	184.50				
	183	5	380.05				
	185	16	1,475.20				
	187	7	701.47				
			$ 75,543.82				

A reserve for $1,300.00 was set up on 12/31/17 to cover expected loss on realization from sales of Style 180 — Work in Process and Finished Stock being approximately 50% thereof. There is practically no market for this style.

F. L. Barnes & Co.

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Inventory Reserve

Provision 1915 to cover losses on specials	$ 1,100.00
Charged off in 1916 - losses on specials manufactured and sold below cost	765.42
Balance which management says is a fair allowance for depreciation of finished stock on display	$ 334.58
Provision Dec. 31, 1917 for losses on realization of Style 180	1,300.00
	$ 1,634.58

Additions to this reserve have been made in Adj. J/E (3) and (4)

COMPLETE ACCOUNTING COURSE--PART II

Lecture 20

INVESTMENTS; DEFERRED CHARGES

Problem 43

The following are the balance sheets on December 31, 1918, of the A and B Companies, respectively:

A COMPANY

ASSETS		LIABILITIES	
Land and Buildings	$112,500.00	Capital (100,000 shares of $5 each, fully paid)	$500,000.00
Machinery and Plant	163,295.00		
Sundry Debtors	123,410.00	Sundry Creditors	90,645.00
Inventories	193,200.00	Reserve	35,000.00
Cash in Bank and on Hand	115,440.00	Surplus--Balance	82,200.00
	$707,845.00		$707,845.00

B COMPANY

ASSETS		LIABILITIES	
Machinery and Plant, Cost	$111,200.00	Capital (6,000 shares at $25 each, fully paid)	$150,000.00
Sundry Debtors	31,245.00		
Inventories	47,115.00	Sundry Creditors	51,350.00
Cash	645.00		
Surplus--Balance	11,145.00		
	$201,350.00		$201,350.00

It is agreed that the business shall be consolidated by the A Company purchasing the B Company as on December 31, 1918, on the following basis:

1. Dividend of 15% to the shareholders of A Company, to be declared prior to the consolidation.
2. The A Company to take over the assets of the B Company, the consideration being:
    - (a) The payment of the liabilities of the B Company.
    - (b) The payment of the costs of consolidation.
    - (c) The issue to the shareholders of the B Company of 7 fully paid shares of $5 each in the A Company for every 2 fully paid shares in the B Company.

The cost of consolidation amounted to $6,030. The machinery and plant and the floating assets of the A Company were worth the values stated on the balance sheet.

Draft the journal entries recording the purchase in the books of the A Company, and set out the balance sheet of the A Company after the consolidation, assuming no cash payments have been made.

Problem 44

A corporation is formed January 1 with a nominal capital of $5,000,000 in $50 shares. There is a first issue of 50,000 shares, $2.50 per share being due on application; $7.50, making $10, due on allotment, January 14; $10 due on February 1; and $10 due on April 1. Balance subject to call. Applications were received for 44,652 shares, and 43,822 were allotted on January 14.

Give the journal entries required to record these facts.

Problem 45

Under the laws of the State of Maine, certain companies were taken over by a newly organized corporation which bought their entire assets and conducted the business for several months before it was discovered that the inventories upon which the transaction was first based were overstated to the extent of $10,000 in the case of one of the constituent companies by reason of a clerical error. It was further found that it would be impracticable to recover said $10,000, or any portion of it, from any of the original companies, or from any of the original stockholders.

The balance sheet of the Maine corporation, prior to the discovery of the error in inventory, was as follows:

ASSETS		
Plant	$268,137.00	
Good-Will and Patents	28,967.49	
Cash	5,638.35	
Bills Receivable	13,282.22	
Accounts Receivable	117,203.88	
Inventories	232,751.42	$665,980.36
LIABILITIES		
Capital Stock	$500,000.00	
Accounts Payable	22,684.26	
Bills Payable	102,000.00	
Surplus	41,296.10	$665,980.36

What entries would the bookkeeper be justified in making to adjust the accounts? Give reasons for your answer.

MISCELLANEOUS QUESTIONS

Question 111--A company shows among its assets $2,675 as unexpired insurance on January 1, 1918. On February 1, 1918, the plant is destroyed by fire and a total loss of $57,875 occurs, which the insurance company pays. How would you treat the $2,675 unexpired insurance item?

Question 112--As an auditor, how would you undertake to satisfy yourself in regard to the following items carried on the balance sheet as investments:

(a) First mortgage 6% bonds of the Progressive Manufacturing Co., par value $100,000, cost value $99,000, market value $96,000.

(b) Second preferred shares in the New Manufacturing Co., value $155,000, par value $175,000, market value $160,000.

Question 113--How would you verify the extensions of an inventory taken by a large 5 and 10 cent store?

Question 114--Would you regard the following items as proper ones to carry forward as Deferred Charges at December 31, 1918:

(a) Advertising expenditures--spring season of 1919, $8,311.83.

(b) Traveling expenses of salesmen in disposing of goods for shipment in that season, $41,073.24.

(c) Proportion general and office expenses considered to have been incurred in connection with securing of orders for delivery in the 1919 season, $11,045.27.

Question 115--How should the following items be valued for the purposes of a balance sheet:

(a) Investments in other companies held as marketable investments.

(b) Investments in other companies held as permanent investments.
As auditor, how would you satisfy yourself as to these valuations?

Solution to Problem 39

A X COMPANY
STATEMENT OF APPLICATION OF FUNDS
YEAR ENDING DECEMBER 31, 1917

FUNDS WERE OBTAINED FROM THE FOLLOWING SOURCES:		
Sale of Common Stock (250 shares at par)		$ 25,000.00
Income from operations:		
Surplus Net Profits	$52,700.00	
LESS--Book Profit on increase in land valuation	5,000.00	47,700.00
Increase in Reserves:		
Reserve for Depreciation	$38,000.00	
Sinking Fund Reserve	10,000.00	48,000.00
Reduction of Bond Discount Unamortized		1,000.00
Total Funds Provided		$121,700.00
THE FUNDS OBTAINED WERE APPLIED IN THE FOLLOWING MANNER:		
Purchase of new Machinery and Equipment		$ 35,000.00
Preferred Stock retired		15,000.00
Dividends paid		8,100.00
Increase in Working Capital as summarized below		63,600.00
		$121,700.00

SUMMARY OF CHANGES IN WORKING CAPITAL

PARTICULARS	1916	1917	INCREASE	DECREASE
Inventories	$ 88,000.00	$ 65,500.00	$---------	$22,500.00
Accounts Receivable	104,000.00	86,000.00	---------	18,000.00
Investments	65,000.00	71,500.00	6,500.00	---------
Cash	2,500.00	18,100.00	15,600.00	---------
Prepaid Expenses	5,000.00	4,000.00	---------	1,000.00
TOTAL CURRENT ASSETS	$264,500.00	$245,100.00	$22,100.00	$41,500.00
LESS--Accounts Payable	145,000.00	62,000.00	83,000.00	
WORKING CAPITAL	$119,500.00	$183,100.00	$63,600.00	

Solution to Problem 40 | Exhibit A

THE WESTERN MANUFACTURING COMPANY
BALANCE SHEET, DECEMBER 31, 1918

ASSETS

PLANT		$400,000.00	
Less--Reserve for Depreciation		14,000.00	$386,000.00
CURRENT ASSETS:			
Inventories of:			
Raw Material	$10,000.00		
Work in Progress	6,000.00		
Finished Stock	28,575.00	$ 44,575.00	
Customers' Accounts	48,000.00		
Less--Reserve for Bad Debts	720.00	47,280.00	
Cash in Bank and on Hand		11,500.00	103,355.00
DEFERRED CHARGES:			
Unexpired Insurance			1,200.00
			$490,555.00

LIABILITIES

CAPITAL STOCK:		
Authorized	$400,000.00	
Issued and Outstanding		$350,000.00
FIRST MORTGAGE 6% GOLD BONDS		
Issued and Outstanding		150,000.00
CURRENT LIABILITIES:		
Accounts Payable	$ 35,000.00	
Accrued Bond Interest	9,000.00	
Accrued Wages	500.00	44,500.00
SURPLUS:		
Balance at January 1, 1918	$ 51,000.00	
DEDUCT--Loss for year ending December 31, 1918 (Exhibit B)	104,945.00	* 53,945.00
		$490,555.00

*Red.

Exhibit B

THE WESTERN MANUFACTURING COMPANY
STATEMENT OF PROFITS AND INCOME
FOR YEAR ENDING DECEMBER 31, 1918

(Number of tons sold, 190,000)

			PER TON
SALES	$228,000.00		
Less--Discount on Sales	7,000.00		
NET SALES		$221,000.00	$1.163
COST OF SALES (Exhibit C)		237,925.00	1.253
GROSS LOSS ON SALES		$ 16,925.00	$ .090
DEDUCT--Miscellaneous Income		4,700.00	
		$ 12,225.00	
ADD--SELLING AND GENERAL EXPENSES:			
Salesmen's Salaries and Expenses	$ 21,000.00		
Bad debts	720.00		
Office Salaries and Expenses	62,000.00	83,720.00	
LOSS FROM OPERATIONS		$ 95,945.00	
ADD--Bond Interest		9,000.00	
TOTAL LOSS TRANSFERRED TO SURPLUS (Exhibit A)		$104,945.00	

Exhibit C

FINISHED STOCK ACCOUNT

	TONS	PER TON	AMOUNT		TONS	PER TON	AMOUNT
Inventory at Jan. 1	12,500	$1.00	$ 12,500	Sales	12,500	$1.00	$ 12,500
				"	177,500	1.27	225,425
Production (Exhibit D)	200,000	1.27	254,000	Inventory at Dec. 31	22,500	1.27	28,575
	212,500		$266,500		212,500		$266,500

NOTE--Two methods of ascertaining the cost of sales are in general use:

1. On the assumption that the inventory on hand at January 1 is sold first, price all sales up to that amount at the opening inventory price.
2. Price all sales at average cost of finished stock to date of sale.

Exhibit D

THE WESTERN MANUFACTURING CO.
STATEMENT OF COST OF MANUFACTURE
FOR YEAR ENDING DECEMBER 31, 1918

MATERIALS USED:		
Inventory of Raw Materials at January 1, 1918	$ 40,000.00	
Materials Purchased less returns	159,500.00	
	$199,500.00	
DEDUCT--Inventory at December 31, 1918	10,000.00	$189,500.00
PRODUCTIVE LABOR		40,500.00
FACTORY EXPENSES:		
Heat, Light, and Power	$ 3,500.00	
Depreciation	4,000.00	
Miscellaneous Factory Expenses	12,500.00	20,000.00
		$250,000.00
ADD--Variation in Work in Progress Inventories:		
Inventory at January 1, 1918	$ 10,000.00	
Inventory at December 31, 1918	6,000.00	4,000.00
COST OF FINISHED PRODUCT MANUFACTURED		$254,000.00

ANSWERS TO QUESTIONS

Answer to Question 101--

1. Obtain a copy of the customers ledger trial balance.

2. Check the balances against the corresponding ledger accounts, noting:

   a) Whether the balance is apparently correct. This is done by scanning the debits and credits without formally footing them.

   b) Whether the balance represents certain specific invoices or is the net balance of a number of debits and credits.

   c) Whether the balance represents current invoices, an old balance carried forward, unpaid notes, drafts, or checks charged back, etc.

   d) Whether the balance as of the closing date has since been liquidated in cash, returns, allowances, etc.

3. Foot the trial balance to see whether the total of the customers ledger trial balance is in agreement with the general ledger controlling account. If there be no controlling account, it is advisable to construct one wherever possible. Whenever possible, verify the balance through communication with

the customer. If this be done, great care must be exercised in order that the balance of the statement sent to the customer is not altered after the auditor has compared same with the ledger account, and that all replies are received by the auditor in such manner that they could not be altered or withheld. The procedure generally preferred is as follows:

a) Statement prepared by bookkeeper in usual way.

b) Statement compared with ledger account by auditor.

c) Rubber stamped with request to examine the statement and notify auditor whether it is correct, or if desired whether it is not correct.

d) Statement mailed by auditor in envelope bearing auditor's return address.

e) Reply received and carefully examined.

f) Second and third request made when considered advisable.

4. In order to ascertain the sufficiency of the reserve for bad and doubtful accounts classify all overdue balances as follows:

PAGE	NAME	AMOUNT	30 DAYS	60 DAYS	90 DAYS	OVER 90 DAYS

Take up these accounts with the credit man or official in charge of collections. Supplement the information obtained from him by an examination of the correspondence with these customers.

Answer to Question 102--A list of the outstanding accounts which each collector is to collect must be prepared in the office, and receipts in duplicate should be written out in the office and handed to the collector in respect of these amounts.

At the end of each week or other period the collector will then either have to account for cash or produce the receipts in respect of those items which he has not yet collected.

The collectors in the various districts should be changed about frequently.

Answer to Question 103--All charges other than sales should be verified to ascertain:

1. The character of such charges.

2. Whether they were properly authorized.

Where such debits are few in number a complete check may be made readily. Where the number involved will not permit of a complete verification, a test is generally resorted to.

Answer to Question 104--The only satisfactory verification of the balances in an officer's account is to obtain the written approval of that officer. Oftentimes an analysis of the account would be presented for his perusal.

Answer to Question 105--

(a) In the case of an agricultural implement manufacturer practically all customers' accounts would be represented by notes. Notes on hand should be

examined and the total compared with the general ledger account. In case notes are out for collection or in litigation they should be verified by correspondence with the party holding same at the date of the audit. Notes paid between the closing date and the date of audit are verified by examination of the cash receipts book. Overdue notes should be classified in the same manner as overdue accounts receivable. In determining the adequacy of the reserve for bad and doubtful notes it should be noted that in the implement business the fact that a note is long overdue is not in itself evidence of non-collectibility. Oftentimes the accrued interest is not taken up. In such cases it may be considered an offset to the collection expenses not reserved for.

(b) In the case of a retail department store the notes on hand would be verified in the manner outlined above. In determining the adequacy of the reserve for bad and doubtful notes it should be noted that in the department store business notes receivable are a sign of financial weakness and overdue notes are generally doubtful of collection.

REFERENCES:
Montgomery, pages 99-103; 128-133
Wildman, pages 43-47; 142-147

F. L. Barnes & Co.

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Unexpired Insurance $3,154.81

Unexpired Insurance

Policy	No.	Insurer	Date	Term	Amount	Premium Total	Premium Unexpired
Tornado	T 43,418	St. Paul Ins. Co.	May 20, 1918	5 years	$15,000.00	150.00	$131.67
Steam Boiler	VE 5,627	Royal Indemnity	June 10, 1918	3 years	5,000.00	300.00	244.44
Trucks	TR. 7,786	Royal	Apr. 15, 1918	1 year	4,000.00	360.00	105.00
1.2% Payroll Liability	G.O. 89,412	Aetna	July 1, 1918	1 year	150,000.00	1,742.50	936.85 (1)
Sprinkler	246,794	Casualty Co. of A.	June 1, 1917	3 years	2,000.00	110.00	51.94
Office Burglary	633,285	U.S. Fidel. & Gu. Co.	Jan. 1, 1918	3 years	5,000.00	116.00	77.33
F. L. Barnes	837,451	Mutual Benefit	Sept. 16, 1918	1 year	20,000.00	448.96	336.74 (2)
Fire	134,261	Aetna	Nov. 1, 1918	"	30,000.00	150.00	125.00
"	3,458,982	Hartford	"	"	25,000.00	125.00	104.17
"	273,941	Globe	"	"	75,000.00	375.00	312.50
"	12,756	Phoenix	"	"	100,000.00	500.00	416.67
"	3,232,636	Equitable	"	"	75,000.00	375.00	312.50
		Total Unexpired					$3,154.81

(1) Premium Paid $1,742.50
Estimated Excess
due to overestimation of payroll 131.20
$1,611.30

½ of $1,611.30 = $805.65
Add estimated refund 131.20
$936.85

(2) Premium paid $448.96
Less expected dividend 64.20
$384.76
$\frac{3\frac{1}{2}}{12}$ of $384.76 = 112.22
$272.54
Add expected div. 64.20
$336.74

F. L. Barnes & Co.

Prepaid Interest	$ 200.00	13
Prepaid Rent	1,120.00	

Prepaid Interest—

Bank Loan for $30,000 dated Dec. 11 1918 due in 60 days - Commerce National Bank 6% — $ 200.00

Prepaid Rent—

Office Rent in Chicago was paid 6 months in advance on year lease dated Nov. 1, 1918 - $280 per month — $ 1,120.00

F. L. Barnes & Co.

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Liberty Bonds $20,000.00

3rd Loan =

Subscriptions as follows –

May 1	$ 10,000.00			
" 3	5,000.00	$ 15,000.00	Examined bonds in vaults of Northern Trust Co. 15 - $1,000 #5604712-3-4-5-6; #5604893-5604902 inclusive. Sept. 15 coupons clipped	
Accrued Interest Sept. 15 - Dec. 31 =				$ 188.63

4th Loan –

Subscriptions as follows –

Oct. 15	10%	$ 1,000.00	
Nov. 21	20%	2,000.00	
Dec. 19	20%	2,000.00	
		$ 5,000.00	

3rd & 4th Instalments due Jan. 16 and 30 – $2,500 each

F. L. Barnes & Co

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Investment in Improved Kitchen Cabinet Co.

Balance – January 1, 1918	$ 18,100.00
10 shares purchased 7/1/18	1,000.00
	$ 19,100.00

Original purchase made 3/1/15 consisting of 181 shares. Examined correspondence and other records covering same, also cashbook and canceled checks and found original payment to have been at par.

The Improved Kitchen Cabinet Co. was organized by M. T. Barnes and others to handle disposition of product. The investment is permanent.

Total shares of Imp. K. C. Co. outstanding = 550, balance being held by Harmon Cabinet Co. (179) and Grand Rapids Household Devices Co. (180). Purchase of 10 shares made from the latter.

Correcting entry (#6) made on account of cost of 10 shares.

Balance in this account should be – $ 19,000.00

F. L. Barnes & Co.

Investment in D. B. Story Manufacturing Co.

1/1/17	Purchase of 200 shares at 150		$ 30,000.00
12/31/17	Profits for year ending 12/31/17	$ 4,054.85	
	4/5ths of above	$ 3,243.88	
	Less-Dividend received 7/1/17	1,000.00	2,243.88
12/31/18	Profits for year ending 12/31/18	$ 2,241.20	
	4/5ths of above	$ 1,792.96	
	Less-Dividend received 7/1/18	1,000.00	792.96
			$ 33,036.84

F. L. Barnes & Co. owns 200 out of 250 shares. See comments on pages 2 and 3 of Mis. Information. The balance sheet on 12/31/18 follows –

Assets			Liabilities	
Current Assets –			Current Liabilities –	
Cash	$ 347.50		Accounts Payable	$ 2,387.12
Accounts Receivable	2,137.58		Accrued Wages	380.80
Raw Materials	3,542.21	$ 6,027.29	Accrued Federal Taxes	27.44
Unexpired Insurance		124.40	Total Current Liabilities	$ 2,795.36
Liberty Bond - 2nd Loan		1,000.00	Net Worth –	
Fixed Assets –			Capital Stock	$ 25,000.00
Land	2,000.00		Surplus - Balance 1/1/17	8,152.78
Buildings	11,246.36		Profits - 1917	4,054.85
Machinery	19,475.75		Profits - 1918	2,241.20
Mis Equipment	2,311.28			$ 39,448.83
	$ 35,033.39		Less Dividends 1917, 1918	2,500.00
Less Depreciation Res.	2,440.89	$ 32,592.50	Total Net Worth	$ 36,948.83
		39,744.19		$ 39,744.19

The Profit and Loss account for 1918 appears below –

Inventory - Jan. 1 1918 (Raw Matl.)	$ 2,347.74	Sales	42,414.58
Purchases during year	12,090.32	Inventory Dec. 31, 1918	3,542.21
Direct Labor	15,700.33	Interest Liberty Bonds	40.00
Indirect Labor	2,471.17	Discounts on Purchases	412.40
General Factory Expenses	1,189.72		
Salary of Officers	4,350.00		
Office Salaries	3,200.01		
Office Expenses	398.47		
Selling Expenses	1,892.79		
Federal Income Tax - 1918	27.44		
Balance: Net Profit for year (to Surplus)	2,241.20		
	$ 46,409.19		$ 46,409.19

Permission from C. I. R. is to be requested in order to file an independent Federal Income Tax return.

F. L. Barnes & Co. 17

Cash and Securities in hands of Sinking Fund Trustee

Atlas Trust Company - Trustee

under the Trust Deed

Date	Particulars	Cash	Investments	Together
Dec. 31, 1917	Check #47351	$ 10,000.00	– –	$ 10,000.00
June 15, 1918	Interest 6%	275.00	– –	275.00
" " "	Liberty Bonds - 1st Issue purchased at 98 (par $10,300)	(10,094.00)	$ 10,094.00	– –
Dec. 15, 1918	Interest on L. L. (1¾%)	180.25	– –	180.25
Dec. 31, 1918	Interest on Cash balance (6%)	6.33	– –	6.33
Dec. 31, 1918	Trustee's Expenses	(50.81)	– –	(50.81)
Dec. 31, 1918	Check #3475	10,000.00	– –	10,000.00
		$ 10,316.77	$ 10,094.00	$ 20,410.77

The trust deed provides - inter alia -

(1) Yearly instalments of $10,000 per year for nine years; balance necessary in 10th year.

(2) Atlas Trust Co. - sinking fund trustee.

(3) Trustee to allow 6% simple interest on balances at end of year and on amounts received during year.

(4) Coupons are payable at company's offices.

(5) Trustee to be allowed ½ of 1% on all cash invested by him in addition to any expenses actually incurred by him.

(6) Investments to be made by trustee at his discretion in government bonds only.

(7) Trustee to deduct his expenses at end of year without interest.

COMPLETE ACCOUNTING COURSE--PART II

Lecture 21

FIXED ASSETS

Problem 46

The Smith Manufacturing Co. with $1,000,000 capital stock, the Young Manufacturing Co. with $500,000 capital stock, and the Star Manufacturing Co. with $400,000 capital stock, agree to consolidate as the Universal Manufacturing Corporation, the new company to buy all the properties of the old companies, at a valuation to be fixed by appraisal, payment therefor to be made in full-paid stock of the new company, the old companies to pay off their own indebtedness.

The appraised values of the old companies are as follows:

	REAL ESTATE AND BUILDINGS	PLANT	CASH	BILLS RECEIVABLE	HORSES WAGONS, & HARNESS	OFFICE FURNITURE	TOTAL
Smith	$680,000	$390,000	$15,000	$10,000	$4,000	$1,000	$1,100,000
Young	327,000	160,000	3,000	6,000	3,000	1,000	500,000
Star	126,000	71,000	1,000	----	1,500	500	200,000
The appraised value							$1,800,000

On this valuation the Universal Manufacturing Corporation issued $2,000,000 of stock, shares $100 each, which was divided pro rata among the old companies on the basis of their appraised value, no fractional shares of stock to be issued, odd amounts to be paid old companies in cash.

Give journal entries necessary to set up property accounts and credit old companies with their pro rata on the books of the new company.

At the time of the consolidation the ledger accounts of the Star Manufacturing Co. were as follows:

Real Estate and Buildings	$250,000.00	Capital Stock	$400,000.00
Plant	247,000.00	Bills Payable	50,000.00
Cash	1,000.00	Accounts Payable	51,000.00
Horses, Wagons, and Harness	1,800.00		
Office Furniture	1,200.00		
	$501,000.00		$501,000.00

Make proper journal entries to liquidate in stock of the new company the liabilities other than capital stock, to apportion the remaining stock and cash, and to close the books of the Star Manufacturing Co.

Problem 47

Charles and Robert Wilson are copartners in a manufacturing business, trading under the firm name of Wilson Bros. Following is a statement of the firm's financial condition December 31, 1918:

Real Estate and Buildings	$165,000.00	Notes Payable	$ 6,000.00
Machinery and Fixtures	39,000.00	Accounts Payable	34,000.00
Horses, Trucks, and Harness	4,500.00	Charles Wilson--Capital	150,000.00
Patents	1,500.00	Robert Wilson--Capital	60,000.00
Stocks and Materials	20,000.00		
Notes and Loans Receivable	5,000.00		
Accounts Receivable	15,000.00		
	$250,000.00		$250,000.00

A company under the corporate title of Wilson & Wilson, Incorporated, is organized with a capital stock of $300,000, of which $60,000 is cumulative preferred stock and $240,000 common stock (both $100 par value), to acquire and conduct the business of Wilson Bros. Charles and Robert Wilson and Henry Miller each subscribe for $10,000 of common stock. The company votes to acquire the interest of Charles and Robert Wilson in the business, real estate, plant, outstanding accounts, etc., of Wilson Bros. and to assume the firm's indebtedness of $40,000 in consideration of the sum of $210,000 and to pay therefor 2,100 shares of the common stock of the corporation, 1,500 shares to be issued in the name of Charles Wilson and 600 shares in the name of Robert Wilson. The company votes to place a mortgage on its real estate and plant for $50,000 to secure an issue of $50,000 first mortgage 5% gold bonds of the denomination of $1,000 each. The creditors subscribe for preferred stock to the amount of 50% of the amounts due them and take bonds at par for the remainder.

Make all entries for the foregoing transactions in the order of their occurrence, giving the details to be found in ledgers and all subsidiary books of account and record.

QUESTIONS ON AUDITING

Question 116--Outline the procedure you would adopt in the verification of goods purporting to be out on consignment.

Question 117--You are auditing the balance sheet of a finance company made up to August 31. You find that $25,000 Mill of San Francisco stock was sold on the previous 29th of August, and as evidences of this you are shown a broker's contract of that date, which discloses that the stock is sold for delivery on the 15th of September following. In the balance sheet the broker is included among sundry debtors for the amount of the contract. Is this right? State your reasons and say how you would verify the asset.

Question 118--A company, of which you are the auditor, makes an issue of shares for the purpose of providing money to build a factory and equip it with plant and machinery, and proposes to pay interest on such shares out of capital, at the rate of 5% per annum, during the construction of the factory. Write a letter to the directors, giving them your views.

Question 119--In the audit of a wholesale coal company you find that coal in transit has not been included in the inventory which is listed on the balance sheet. As an auditor engaged to certify to the foregoing balance sheet what attitude would you take in respect to an item of that character?

In case you suspected that the coal stated to be "in transit" was actually on hand, how would you proceed to ascertain the facts as to whether or not such coal was on hand at the date of the balance sheet?

Question 120--As auditor, to what extent would you hold yourself responsible for the inventory of a retail department store with gross sales of $2,500,000 annually?

Solution to Problem 41

FOUNDRY DEPARTMENT
COST OF PRODUCTION FOR MONTH OF MARCH

(Number of pounds produced, 1,200,000)

	AMOUNT	PER LB.
Materials Used	$39,083.27	
Productive Labor	38,092.78	
General Foundry Expenses	19,027.83	
	$96,203.88	$0.0801699

(1)

Work in Progress	$82,334.49	
To--Foundry Department Account		$82,334.49

For cost of castings produced during the month of April under the following orders:

ORDER NO.	LBS. OF CASTINGS	AMOUNT*
196	304,000	$24,371.65
198	100,000	8,016.99
203	98,000	7,856.65
206	350,000	28,059.47
209	175,000	14,029.73
	1,027,000	$82,334.49

*Average per pound, $0.0801699.

(2)

Work in Progress	$97,210.71	
To--General Stores Department		$97,210.71

Value of materials issued during the month of April by the general stores department against the following orders:

ORDER NO.	AMOUNT
196	$11,088.12
198	9,001.33
201	12,081.32
207	11,091.33
208	31,083.27
212	13,827.23
215	9,038.11
	$97,210.71

(3)

Work in Progress	48,729.95	
To--Wages Payable		48,729.95

Distribution of productive labor during the month of April:

ORDER NO.	HOURS	AMOUNT
196	11,000	$ 4,608.07
198	10,000	3,812.08
201	13,000	5,708.91
207	14,000	6,103.27
208	52,000	18,081.33
212	16,000	6,308.02
215	10,500	4,108.27
	126,500	$48,729.95

(4)

Work in Progress	38,083.11	
To--General Factory Expense Account		38,083.11

Distribution of general factory expenses against the various orders month of April:

ORDER NO.	MACHINE HOURS	AMOUNT*
196	11,000	$ 3,311.58
198	10,000	3,010.52
201	13,000	3,913.68
207	14,000	4,214.73
208	52,000	15,654.72
212	16,000	4,816.83
215	10,500	3,161.05
	126,500	$38,083.11

*Rate per hour, $0.30105225.

(5)

Cost of Goods Sold Account		$109,309.54	
To--Work in Progress Account			$109,309.54

Cost of orders completed and shipped during the month of April:

ORDER NO.	CASTINGS	GENERAL STORES	PRODUCTIVE LABOR	PROP'N FACT'Y EXP.	TOTAL
196	$24,371.65	$11,088.12	$4,608.07	$3,311.58	$43,379.42
198	8,016.99	9,001.33	3,812.08	3,010.52	23,840.92
206	28,059.47	--------	--------	--------	28,059.47
209	14,029.73	--------	--------	--------	14,029.73
	$74,477.84	$20,089.45	$8,420.15	$6,322.10	$109,309.54

(6)

Customers' Accounts	111,000.00	
To--Sales Accounts		111,000.00

The following orders were shipped during the month of April:

ORDER NO.	CONTRACT PRICE
196	$ 35,000.00
198	21,000.00
206	35,000.00
209	20,000.00
	$111,000.00

STATEMENT OF GROSS PROFITS ON CONTRACTS
SHIPPED DURING THE MONTH OF APRIL

ORDER NO.	CONTRACT PRICE	COST	GROSS PROFIT or LOSS*
196	$ 35,000.00	$ 43,379.42	*$8,379.42
198	21,000.00	23,840.92	* 2,840.92
206	35,000.00	28,059.47	6,940.53
209	20,000.00	14,029.73	5,970.27
	$111,000.00	$109,309.54	$1,690.46

Solution to Problem 42

Exhibit I

JOHN ANSON COMPANY
BALANCE SHEET, JULY 31, 1919

ASSETS

CURRENT ASSETS:		
Cash	$10,870.30	
Accounts Receivable (Less--Reserve for Discounts $275)	15,518.94	
Merchandise on Hand	5,473.82	$31,863.06
PREPAID INSURANCE		956.83
FURNITURE AND FIXTURES	$ 3,745.00	
LESS--Reserve for Depreciation	2,500.00	1,245.00
		$34,064.89

LIABILITIES

CURRENT LIABILITIES:		
Accounts Payable for:		
Cartage	$ 37.60	
Freight	14.82	
General Expense	44.66	
Accrued Taxes	256.90	
Sales on Consignments not closed out (Less--Freight $190.55, Cartage $13.43, Drafts $1,248.51, and Commissions $2,111.16)	13,411.77	$13,765.75
NET WORTH:		
Capital Stock	$10,000.00	
Surplus--Balance June 30, 1919	7,774.82	
Profits for July (including gross profit of $2,111.16 on consignments partially sold)	2,524.32	20,299.14
		$34,064.89

Exhibit II

JOHN ANSON COMPANY
STATEMENT OF PROFIT AND LOSS
FOR MONTH ENDING JULY 31, 1919

SALES		$5,649.31
Deduct--Cost of Goods Sold:		
Inventory July 1, 1919	$ 4,545.67	
Purchases	5,463.81	
	$10,009.48	
Less--Inventory July 31, 1919	5,473.82	4,535.66
GROSS PROFITS ON SALES		$1,113.65
ADD--Commissions from Consignments (Out of Sales totaling $33,034.78)		3,556.54
		$4,670.19
LESS--Discounts Allowed Customers		893.50
GROSS PROFITS FROM OPERATIONS		$3,776.69
DEDUCT--SELLING AND GENERAL EXPENSES:		
Clerk's Salaries	$ 475.00	
Office Salaries	330.00	
Rent	125.00	
Postage and Stationery	53.67	
Insurance	42.78	
General Expenses	100.81	
Taxes	35.16	
Depreciation on Furniture	100.00	1,262.42
NET PROFIT FROM OPERATIONS		$2,514.27
ADD--Miscellaneous Income--Interest on Bank Balance		10.05
SURPLUS NET PROFIT FOR JULY, 1919		$2,524.32

ANSWERS TO QUESTIONS

Answer to Question 106--

1. Obtain the original inventory sheets.
2. Compare the quantities with the stores records if such records are kept.
3. Compare the prices with the latest invoices and market quotations.
4. Test the extensions.
5. Prove the footings.
6. Selecting certain important items, set up a comparative inventory sheet as follows:

	DECEMBER 31, 1917			DECEMBER 31, 1918		
ITEM	QUANTITY	PRICE	AMOUNT	QUANTITY	PRICE	AMOUNT

7. Note the trend of the quantities.
8. Note whether the inventory sheets bear the initials of parties taking, pricing, extending, and footing same.
9. Obtain certificate from one or more officials as to the correctness of the inventory as a whole.
10. Ascertain whether there are any obsolete or other unusable materials listed in the inventory.
11. Are all goods received up to the balance sheet date included?
12. Ascertain whether goods received on consignment are listed as goods owned.
13. Ascertain whether goods shipped on consignment are included in the inventory.

Answer to Question 107--Ordinarily, it is not permissible to take up profits on uncompleted work. The only exception would arise in the case of contracts requiring a very long period for completion. If such contracts were undertaken by a steel products manufacturing company they could be subdivided into sections and the profit and loss determined separately on each. If the contract covered the production of a large quantity of items of the same general character, it would be proper to take up the profit on each lot when shipped.

Answer to Question 108--

1. Obtain the original inventory sheets.
2. Compare the quantities with the stock records if such records are kept.
3. Compare the prices with the cost records upon which they are based. Analyze the cost system in use in order to ascertain whether the costs obtained through the operation of that system are approximately correct.
4. In case no cost system is in use, ascertain the basis upon which the prices were determined, and ascertain whether that basis is approximately correct.
5. Test the extensions.
6. Prove the footings.
7. Selecting certain important items, set up a comparative inventory sheet as follows:

	DECEMBER 31, 1917			DECEMBER 31, 1918		
ITEM	QUANTITY	PRICE	AMOUNT	QUANTITY	PRICE	AMOUNT

8. In case process costs can be obtained, compare the per unit cost of each production expense with the corresponding item in previous years.
9. In case test costs are used, ascertain the manner in which such test costs were obtained and the procedure used to verify the correctness of such test costs.
10. Note the trend of the quantities, especially in relation to volume of sales.
11. Inquire as to obsolete or other unsalable stock, especially the prices used.
12. Note whether the inventory sheets bear the initials of parties taking, pricing, extending, and footing same.

13. Obtain certificate from one or more officials as to the correctness of the inventory as a whole.
14. Ascertain whether all goods shipped up to inventory date have been excluded from the inventory sheets.
15. Ascertain whether the selling prices less estimated selling expense is above the inventory price.

Answer to Question 109--In the case of a bicycle inventory, the auditor would be justified in relying upon the cost records for inventory cost prices in case:

1. The cost system is based on correct principles.
2. The costs are being properly compiled.
3. Nothing arises during the course of the audit to cast doubt on the reliability of the cost records.

Answer to Question 110--

(a) The gross profit test refers to a comparison of the percentage of gross profit to net sales from year to year. These percentages are readily calculated from the periodical statements of profits and income.

(b) The comparative inventory test refers to a comparison of the quantities and unit prices of certain items selected from two or more periodical inventories. See Answer to Question 106 (6).

REFERENCES:
Montgomery, pages 104-120
Wildman, pages 130-134

F. L. Barnes & Co.

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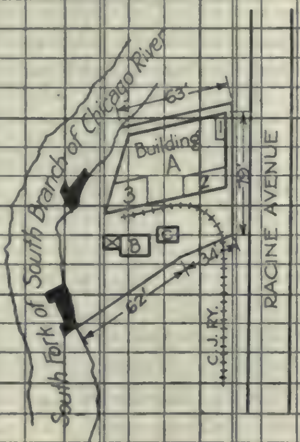
Land

Jan. 25-1914- Purchased from Central Manufacturing District an irregular tract of land between Racine avenue and the south branch of the Chicago River; thus:



Examined Deed and other data covering purchase, including receipt from C. M. D. for payment of $32,000.00 cash, and Guaranty Policy from Chicago Title and Trust Co.

Jan. 25, 1914-	Cash payment to Central Manufacturing District	$ 32,000.00
Mar. 31, 1914	Legal Fees re-title, etc. in connection with purchase	250.00
		$ 32,250.00
	Estimated value per 1917 Chicago Realty Board, valuation about	$ 45,000.00

F. L. Barnes & Co.

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Analysis of Buildings a/c ①

Construction work has been done by D. V. Root Construction Co., a Chicago concern, and is evidenced (a) by their sworn statements and (b) by the sworn statements of Geo. H. Judson, a consulting engineer who authorized payments during the period of construction.

Building A was put up in May – September 1914
Building B was constructed in October – November 1914.
Building C was constructed in July 1918.

Building A (Factory)

Final statement of D. V. Root Const. Co. rendered Oct. 1, 1914, showing following payments —

	May 6, 1914	Cash	$ 1,200.00		
	June 20, 1914	Cash	15,000.00		
	July 15, 1914	Cash	15,000.00		
	Aug. 25, 1914	Cash	20,000.00		
	Sept. 30, 1914	Final Cash payment	27,256.92	$ 78,456.92	^
	Oct. 15, 1914	Geo. H. Judson – Services 3% of cost		2,353.70	^
		In addition to the above payments (made by the partnership), the following expenditures have been incurred and charged to this account by the corporation —			
	Jan. 15, 1915	Partitions for Factory Office	$ 1,047.55		
	" 25, 1915	Labor, installing same (from Payroll)	289.25	1,336.80	^ (#1 on diagram 1st floor)
	Apr. 18, 1917	Tiling and other Improvements installed in smoking room by Garret, Mahon & Co Inv. 4/5/17		956.56	(#2 on diagram 2nd Floor.)
P.D. p. 84	Mar. 22, 1918	Payroll – Construction of dining room on 2nd floor	$ 175.20		
P.D. p. 87	" 29.	Ditto	216.72		
J.V. #8425	" 31.	Material requisitions #C7695, C7698, C7701, C7750 – lumber, glass, and hardware	633.89		
J.V. #8431	" 31.	Superintendence – 2 weeks	83.33	1,109.14	^ (#3 on diagram) 2nd floor
		Total – Dec. 31, 1918		$ 84,213.12	^

Building B (Power House) =

Construction completed Nov 12, 1914 by D. V. Root Const. Co, as per their final statement Nov 15 listing all invoices and labor payroll plus 10%. Cash in full paid 11/16/14 — $ 6,425.53

Dec. 1, 1914 Geo. H. Judson. Services – 3% of cost — 192.76 ^

$ 6,618.29 ^

F. L. Barnes & Co.

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Analysis of Buildings a/c ②

Building C-(Temporary Kiln)-

July 31, 1918 - Payment to D. V. Root Const. Co.	$ 2,000.00
Aug. 15, 1918 - Ditto - Final	5,486.30
Total - December 31, 1918	$ 7,486.30 ^

The above was also on a cost plus 10% basis. It was explained by Mr. H. E. Barnes that he himself had checked over the construction company's statement and had verified all the items included therein. Moreover, he himself had superintended a portion of the construction and had made certain alterations in the plans. He therefore requested that an adjustment be made in order that his salary for the month of July (during which time he devoted 1/2 his time to the construction of the kiln) be transferred to Buildings a/c. Mr. F. L. Barnes assented to this. See Adj. J/E #7

J. L. Barnes & Co.

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Buildings – Equipment and Fixtures

Balance January 1, 1915			$ 11,330.02	This account includes such items as lights and light fixtures, toilet equipment, drinking fountains, window shades and awnings, steam heating system, etc.
The above is the result of an independent appraisal made under the direction of H. E. and M. J. Barnes in the latter part of 1914, in anticipation of the transfer to the corporation. This figure includes only that portion of fixtures which were to be moved to the company's new building, the previous location having been dismantled in the last two months of 1914.				
Less – Equipment Scrapped –				
July 31, 1915 – Miscellaneous Equipment as per list appearing in J. Voucher #4771, having a value appearing in the list transferred from the partnership of	$ 2,475.50		2,475.50	
Realized on Sale	1,841.00			
Charged to P & L	634.50			
Balance to Dec. 31, 1917			$ 8,854.52	
Additions – 1918				
Skylights on second floor over restaurant and smoking room (Building A)				
V.R. 78 Mar. 15, 1918 – Pittsburgh Glass Co. Invoices of Mar. 5th & 7th		$ 875.75		
J.V. 8424 Mar. 18, 1918 – Material req. #7598		147.34		
P.D. p. 84 Mar. 22, 1918. Payroll – Labor on above		241.58	1,264.67	
			$ 10,119.19	

It was pointed out that the skylights would ordinarily be considered part of Building costs rather than equipment and that an adjusting entry should be made accordingly. See J/E #8.

In addition to above, the cost of 2 heating furnaces, one in the middle of each floor of Building A, purchased in 1918, was found to have been charged to "Repairs and Upkeep – Buildings". Cost was $250 each. See J/E #9. Reason given for their purchase was that the heating plant was insufficient in cold weather.

F. L. Barnes & Co.

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Machinery

Balance Jan. 1, 1915	$ 84,987.41	
Net additions 1915 per audit report of Rex Audit Co.-	6,743.18	
Net additions 1916 " " " "	16,741.54	
" " 1917 " " " "	479.23	$ 108,951.36 ^
Additions 1918—		
2 Wood-turning lathes, model XC4-Sterrett Tool Co.- Inv. dated 4/12/18 @ $875.00		1,750.00
Freight on above		88.52
Installation costs - Labor payroll distribution April 16		24.20
Balance Dec. 31, 1918 per books		$ 110,814.08 ^

Inquiry reveals that one of the above lathes was a replacement. The original lathe cost $680.00 and was taken over by the corporation on Jan. 1, 1915 for $600.00. Three years' depreciation has been provided since at $60.00 a year. The lathe was sold July 1 for $350.00. See Adj. J/E #10

The original valuations were based on depreciated cost, subsequent additions on cost. Depreciated cost was said to be approximately 90% of actual cost, hence depreciation rate of 10% is actually 9% on machinery taken over from partnership.

F. L. Barnes & Co.

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Office Furniture and Fixtures

	Balance Jan. 1, 1915—	None		
	Mr. H. E. Barnes stated that the office equipment previously owned was sold prior to the formation of the corporation.			
	Purchases 1915	$ 1,400.43		
	Purchases 1916	365.80		
	Purchases 1917	441.97	$ 2,208.20	^
	Additions 1918—			
VR/14	Feb. 16, 1918 2 Office Desks			
	M. F. & Co. Inv. 2/14/18	$ 75.20		
VR/101	Aug. 22, 1918 3 Chairs-office swivel			
	M. F. & Co. Inv. 8/5/18	52.50		
	Aug. 22, 1918 1 Rug M. F. & Co. Inv. 8/5/18	104.00		
	" " " 1 Directors Table " "	147.25		
VR/102	Aug. 26, 1918 1 Adding Machine			
	Burroughs A. M. Co. Inv. 8/16/18	325.00	703.95	^
			$ 2,912.15	^

An item was found among the petty cash vouchers from Jan. 1 - Jan. 10, 1919 covering the purchase of 2 office desks on 12/12/18. This to be added to the above (J/E #1) $ 78.80

F. L. Barnes & Co.

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Analysis of Reserve for Depreciation

Particulars	Buildings	Buildings-Equipment and Fixtures	Machinery	Office Furniture and Fixtures	Together
Rate applied on last year's balance	3%	10%	10%	15%	--
Provision for 1915	$ 2,622.87	$ 1,133.00	$ 8,491.74	$ —	$ 12,254.61
" " 1916	2,663.00	885.45	9,173.06	210.07	12,931.58
" " 1917	2,663.00	885.45	10,847.21	264.94	14,660.60
" " 1918	2,691.67	885.45	10,895.14	331.23	14,803.49
Adj. J/E #10			180.00		180.00
Balance Dec. 31, 1918	$ 10,640.54	$ 3,789.35	$ 39,234.15	$ 806.24	$ 54,470.28

COMPLETE ACCOUNTING COURSE--PART II

Lecture 22

INTANGIBLE ASSETS

Problem 48

The following trial balance was abstracted from the general ledger of the White Manufacturing Co. as of December 31, 1918.

ACCOUNT	DEBITS	CREDITS
Capital Stock		$200,000.00
Surplus		69,304.48
Real Estate	$24,000.00	
Buildings	36,783.11	
Machinery and Equipment	87,105.99	
Notes Receivable	21,678.03	
Customers' Accounts	96,798.93	
Notes Payable		45,000.00
Accounts Payable		39,632.95
Inventory of Raw Materials at January 1, 1918	38,983.45	
Purchases of Raw Materials	293,839.18	
Wages	160,511.92	
Light, Heat, and Power	2,908.38	
Sales		620,033.89
Discounts on Sales	19,419.87	
Discounts on Purchases		6,487.11
Freight-Inward	18,067.50	
Allowances on Sales	13,081.14	
Factory Expenses	6,093.17	
Superintendent's Salary	3,000.00	
Bad Debts	1,314.13	
Officers' Salaries	12,000.00	
Salesmen's Salaries and Commissions	11,425.50	
Freight Outward	10,439.23	
Salesmen's Traveling Expenses	6,638.19	
Cash	10,751.02	
Inventory of Finished Product at January 1, 1918	80,303.93	
Repair and Maintenance Charges	22,037.73	
Interest Received		2,909.45
Interest Paid	4,783.50	
Insurance	1,403.98	
	$983,367.88	$983,367.88

Prepare a balance sheet at December 31, 1918, with relative statement of profits and income. Set out your statements in the best possible form irrespective of the number of accounts involved.

The following items have not been taken into consideration.

1. Inventory of: (a) raw materials, $69,075.23; (b) in process of manufacture, $14,908.17; (c) finished product, $27,575.50.
2. Insurance unexpired, $593.44.
3. Dividend of 3% on the capital stock outstanding payable to the stockholders of record December 31, 1918. The dividend was declared by the board of directors at a meeting held on December 27, 1918, and is payable on January 15, 1919.

Problem 49

A died on June 1, 1918, and his estate consisted of the following:

Cash on Hand	$ 350.00
Cash in Bank	3,137.11
First Mortgage 6% W Ry. Co. Bonds (Interest Payable April 1 and October 1)	75,000.00
6% Mortgage Loans (Interest Payable March 1 and September 1)	40,000.00
Preferred Stock (at par) in the Allen Manufacturing Co.	125,000.00
Notes Receivable (Interest at 5% paid to May 1, 1918)	30,000.00
Household Furniture	1,000.00
Sundry Liabilities	12,000.00

The household furniture was given to his wife and she is entitled to the income from the estate for life.

The following legacies were mentioned in the will: (1) William Brown, $3,000; (2) John Smith, $2,000; (3) A. R. Jones, $1,000.

Funeral expenses amounted to $1,200; probate court costs $1,500; attorney's and accountant's fees $1,200. The preferred stock was sold for $130,000.

On August 1, 1918, the debts were paid, and on August 15, 1918, the legacies.

The income from the investments was received as and when due, and the income collected to October 31, 1918, was paid to the widow on that day.

Prepare:

(a) The necessary opening entries for the executors
(b) Write up the books for the period ending October 31, 1918
(c) Statement of charge and discharge

In what respects (if any) would the foregoing exhibits be altered if the widow died October 31, 1918?

MISCELLANEOUS QUESTIONS

Question 121--A died, leaving an estate consisting of:

Real estate, valued at	$ 30,000.00
Share in partnership, estimated at	175,000.00
Shares of stock	75,000.00
Household furniture	19,500.00
Cash at bankers	4,000.00

The will provided for an annuity of $1,000 payable to testator's wife out of income, the remainder of the income being divisible among his six children equally so long as they live and until the youngest attained the age of 21 years.

What books and accounts would you open for the executors, and what information would you require to enable you to write them up and adjust the capital and income?

Question 122--At November 30, 1918, you are called upon to audit the accounts of the estate of Glenn Richards, for the eleven months ending that date. How would you satisfy yourself as to the accuracy of the opening journal entry as shown by the books?

Question 123--Under the last will and testament of Henry Rogers all the income from his estate consisting of farm land, stocks and bonds, etc., is payable to the widow during her lifetime. After her death, the entire residuary estate is to be a gift to the Memorial Hospital. The income derived from the estate is the widow's sole means of support. Draft the form of cash book to be kept by the trustee.

Question 124--Referring to Question 123, assume Henry Rogers died on March 15. How would you apportion as between principal and income:

(a) Interest from bonds
(b) Dividends from stocks
(c) Rents from farm land

Question 125--Referring to Question 123 and 124, assume the widow of Henry Rogers died on the following April 15, before any moneys had been received in respect of rents, interest, or dividends. Would the entire estate at April 15 pass to the remainderman (the Memorial Hospital), or would some apportionment as between the life tenant (widow of Henry Rogers) and remainderman be called for?

Give full reasons for your answer. If in your opinion an apportionment is called for, outline the procedure required to make such an apportionment.

Solution to Problem 43

JOURNAL ENTRIES

(1)		
Surplus	$ 75,000.00	
To--Dividend Payable		$ 75,000.00
Dividend of 15% declared by the board of directors as of December 31, 1918.		
(2)		
Unissued Stock	105,000.00	
To--Capital Stock		105,000.00
To record increase in capital stock authorized by resolution adopted at stockholders' meeting held on............ See minute book, page......		
(3)		
Machinery and Plant	111,200.00	
Sundry Debtors	31,245.00	
Inventories	47,115.00	
Cash	645.00	
To--B Co. Vendor Account		156,350.00
Capital Surplus		33,855.00
To record purchase of assets from B Co., per agreement dated................and per resolutions adopted by directors at a meeting held on..............; A Co. to pay liabilities of B Co. and to issue 7 shares of preferred stock (par value $5 each) for every 2 shares (par value $25 each) turned in by the B Co. stockholders.		
(4)		
B Co. Vendor Account	51,350.00	
To--Sundry Creditors		51,350.00
To record the assumption of the outstanding liabilities of B Co. in accordance with the agreement dated..............		
(5)		
Consolidation Expenses	6,030.00	
To--Accounts Payable		6,030.00
Expenses incurred in connection with the consolidation.		
(6)		
Capital Surplus	6,030.00	
To--Consolidation Expenses		6,030.00
To write off the consolidation expenses.		

(7)

B Co. Vendor Account	$105,000.00	
To--Unissued Stock		$105,000.00
To record the issue of 21,000 shares of capital stock (par value $5 each) to shareholders of B Co. in full payment for assets turned over, in accordance with the agreement and resolution referred to in entry No. 3.		

A COMPANY

BALANCE SHEET, DECEMBER 31, 1918

ASSETS

CAPITAL ASSETS:		
Land and Buildings	$112,500.00	
Machinery and Plant	274,495.00	$386,995.00
CURRENT ASSETS:		
Inventories	$240,315.00	
Sundry Debtors	154,655.00	
Cash on Hand and in Bank	116,085.00	511,055.00
		$898,050.00

LIABILITIES

CAPITAL STOCK ISSUED AND OUTSTANDING		$605,000.00
CAPITAL SURPLUS (representing excess of value of the sundry assets acquired from B Co. over the par value of the stock issued in payment therefor)	$ 33,855.00	
DEDUCT--Consolidation Expenses	6,030.00	27,825.00
CURRENT LIABILITIES:		
Sundry Creditors	$141,995.00	
Accounts Payable in respect of Consolidation Expenses	6,030.00	
Dividend Payable	75,000.00	223,025.00
RESERVE		35,000.00
SURPLUS ACCOUNT:		
Balance at	$ 82,200.00	
DEDUCT--Dividends Declared	75,000.00	7,200.00
		$898,050.00

Solution to Problem 44

JOURNAL ENTRIES

(1)		
Unissued Stock	$2,767,400.00	
Application and Allotment	2,232,600.00	
To--Authorized Issue Capital Stock		$5,000,000.00
To record the authorized issue of capital stock per minutes of stockholders' meeting held on .... and certificate issued by the Secretary of State under date of		
(2)		
Cash	111,630.00	
To--Application and Allotment Account		111,630.00
Application for 44,652 shares, $2.50 per share received in cash.		
(3)		
First Call Account	328,665.00	
To--Application and Allotment Account		328,665.00
First call of $7.50 per share on 43,822 shares allotted.		
(4)		
Cash	328,665.00	
To--First Call Account		328,665.00
Cash received on first call.		
(5)		
Application and Allotment Account	2,075.00	
To--Cash		2,075.00
Return of payment on application of $2.50 per share on 830 shares not allotted.		
(6)		
Second Call Account	438,220.00	
To--Application and Allotment Account		438,220.00
Second call of $10 per share on 43,822 shares allotted.		
(7)		
Cash	438,220.00	
To--Second Call Account		438,220.00
Cash received on second call.		

(8)

Third Call Account	$438,220.00	
To--Application and Allotment Account		$ 438,220.00
Third call of $10 per share on 43,822 shares allotted.		

(9)

Cash	438,220.00	
To--Third Call Account		438,220.00
Cash received on third call.		

ALTERNATIVE SOLUTION

(1)

Unissued Stock	$5,000,000.00	
To--Capital Stock--Authorized		$5,000,000.00
To record authorized issue of 100,000 shares, par value $50 each, as per minutes of stockholders' meeting held on .... See certificate issued by the Secretary of State under date of		

(2)

Cash	111,630.00	
To--Applications for Stock Subscriptions		111,630.00
To record receipt of deposit of $2.50 per share on 44,652 shares applied for.		

(3)

Subscriptions	2,191,100.00	
To--Unissued stock		2,191,100.00
To record allotment of 43,822 shares par value $50 each.		

(4)

Subscription Instalment #1	438,220.00	
Subscription Instalment #2 (February 1)	438,220.00	
Subscription Instalment #3 (April 1)	438,220.00	
To--Subscriptions		1,314,660.00
To record instalments called on date of allotment.		

(5)

Applications for Stock Subscriptions	$111,630.00	
To--Subscription Instalment #1		$109,555.00
Cash		2,075.00
To record return of deposit of $2.50 per share on 830 shares applied for but not allotted, and application of balance of deposits on Subscription Instalment #1.		

(6)

Cash	328,665.00	
To--Subscription Instalment #1		328,665.00
To record receipt of $7.50 per share on 43,822 shares, being balance due January 14.		

(7)

Cash	438,220.00	
To--Subscription Instalment #2		438,220.00
To record receipt of Instalment #2 due on February 1.		

(8)

Cash	438,220.00	
To--Subscription Instalment #3		438,220.00
To record receipt of Instalment #3 due on April 1.		

Solution to Problem 45

Under the circumstances referred to in the problem, the amount of $10,000 is a proper charge to Good-Will, because the new company acquired less in the way of tangible assets than it supposed at the time the property was purchased. Before the bookkeeper spreads the entry on the books, the proposed treatment should be passed upon by the board of directors or at least the executive officers of the company.

It may be the desire of the board to write off the amount to the Accumulated Surplus account. In so doing it would be desirable for them to adopt resolutions instructing the accounting officer to deal with the item in that manner. In the event it is decided to write off the item, the whole transaction should be clearly set forth in the accounts of the year in which the write-off took place.

ADJUSTING ENTRIES ON THE CORPORATION'S BOOKS

Good-Will	$10,000.00	
To--Inventories		$10,000.00
To charge off the clerical error of $10,000 in the calculation of the inventories taken over from the..........company. See page.....of minute book for resolution authorizing this charge adopted by the board of directors at a meeting held on		

ALTERNATIVE ENTRY

Surplus	$10,000.00	
To--Inventories		$10,000.00
To charge off the clerical error of $10,000 in the calculation of the inventories taken over from the .... company. See page ... of minute book for resolution authorizing this charge adopted by the board of directors at a meeting held on		

ANSWERS TO QUESTIONS

<u>Answer to Question 111</u>--The first step would be to verify the amount of unexpired insurance at January 1, 1918. If this amount had been properly calculated the proportion pertaining to the month of January, 1918, should be charged to the operations of that month. The balance is properly chargeable to the Fire Insurance Recovery account, inasmuch as a total loss having been incurred and settled for, the insurance company has no further liability under the policy.

<u>Answer to Question 112</u>--

(a) First mortgage 6% bonds of the Progressive Manufacturing Co., par value $100,000. The bonds should be inspected, and preferably the inspection should be made on the date of the balance sheet. The market value is $3,000 less than the cost or book value, and it would seem desirable, if not necessary, to introduce a reserve to cover the possible loss on realization. The voucher covering the purchase of the bonds in the first instance should be examined.

(b) Second preferred stock (par value $175,000). The shares evidencing this stock ownership should be inspected on the date of the balance sheet if possible. The market value is $5,000 in excess of the cost value and therefore the inclusion of the asset in the balance sheet at the cost value would be the conservative treatment to adopt. The voucher issued in payment of the shares should be examined as evidence supporting the cost price.

In the case of both (a) and (b) it might be advisable to refer to the minutes of the proceedings of the directors' meetings to determine whether or not the purchases were approved by the board.

Answer to Question 113--An inventory of a large 5 and 10 cent store would consist primarily of a very large number of small items. In verifying the extensions of such an inventory prove the largest items and scrutinize a portion of the others so as to ascertain whether they are approximately correct. In a case of this kind a comptometer or other mechanical device would be of great value.

Answer to Question 114--

(a) Advertising incurred in connection with the sale of goods for the spring season of 1919 may be properly carried forward as a deferred charge, at say December 31, 1918, only in those lines of business which are termed "seasonal" in that the expenses involved in making the sales for a season are generally incurred in one period while the sales are taken up as income in the following period. In such cases there can be no serious objection to the carrying forward of the advertising expense to the period in which the sales are credited. But where the advertising cannot be directly connected with the sales of a particular period, good business practice as well as conservative accounting requires that such advertising be charged off in the period in which the advertisement was run. Any other practice generally results in a constantly increasing accumulation of deferred charges which should have been taken care of in the operations of past periods.

(b) Traveling expenses of salesmen in disposing of goods for shipment in the spring of 1919 would follow the principles outlined in (a). In this case it is somewhat easier to connect the expense with the sales.

(c) It must be admitted that some part of the general and office expenses of 1918 were incurred in connection with the securing of orders for delivery in the 1919 season, and it would therefore seem that such expense is properly chargeable to that season. But it must be noted that where this is done it is essential to provide out of 1918 operations the expense which will be incurred in the collection of accounts and notes receivable, etc.

Consequently it is generally accepted that if these expenses are not unusual in character and are annually recurrent, no portion thereof should be carried forward. But if in any particular case it should be found that a part of these expenses were unusual and pertained solely to the season of 1919, it may be permissible to carry forward as a deferred charge only that portion of the general and office expense.

From an operating point of view it is essential that the practice at the beginning and end of a period shall be the same.

Answer to Question 115--

(a) Investments in other companies held as marketable investments should, in most cases, be valued on the basis of market or cost, whichever is the lower.

(b) Investments in other companies held as permanent investments should be valued at the cost thereof, except for the subsequent adjustment of that value in respect of (1) proportion of profits or losses arising from operations and (2) dividends received.

In this connection it might be well to quote from Mr. Dickinson's paper, "Profits of a Corporation," dealing with the valuation of investments in other companies held as marketable investments:

"The term marketable investments is intended to include only such investments as are part of the circulating as distinct from the fixed assets. The latter class of investments may be defined as those which cannot be disposed of without affecting the operations, for the reason that the ownership thereof in a permanent form is necessary, however remotely, to the business which the corporation is carrying on. Their valuation would be governed by the same principles as have been outlined above for other fixed assets.

"Marketable investments, on the other hand, may be either:

(a) The stock in trade of the corporation.
(b) The investment of surplus cash held in this form until required for ordinary operating purposes.
(c) The investment of a reserve or other special fund.

"In case (a) the rule of cost or market value, whichever is the lower, applied to each individual investment and not to the group as a whole, is undoubtedly the most conservative. That is to say, no profit could be taken up on any investment until it is sold, but on the other hand, where the value has clearly fallen, some provision should be made therefor. Where, however, the investments all have a definitely ascertainable market value at any time, it is perhaps fair and reasonable to allow a fall in value of some individual investments to be set off against a rise in value of others, provided that the aggregate valuation is not above original cost or market value, whichever is the lower.

"In case (b) the usual custom is to value at the mean market price on the last day of the fiscal period for the reason that the investments represent the equivalent of cash and should therefore be maintained at their cash value in the balance sheet.

"In case (c) any profit or loss, either realized or estimated, would be a credit or charge to that fund, and not to the Profit and Loss account. But in the balance sheet such investments should either be clearly stated as maintained at cost or preferably be adjusted each year to the aggregate market value if below cost.

"Another method of dealing with the fluctuations of marketable investments of classes (b) and (c) is to create an investment fluctuation reserve, either out of estimated or realized profits on investments, or by a charge to Profit and Loss of such an amount as may be necessary to prevent this reserve from showing a debit balance, and by charges or credits to this reserve to maintain the asset at market value."

REFERENCES:

Montgomery, pages 120-128; 134-145
Wildman, pages 134; 66-77; 121-129

F. L. Barnes & Co.

Goodwill

At the time of the transfer of the net assets of the partnership to the Corporation the partnership goodwill was estimated at a three year purchase of the average net profits for the preceding seven years. Details follow—

Year Ending December 31	Net Profits		
1908	$ 22,476.11		
1909	20,412.08		
1910	15,919.40		
1911	14,517.86		
1912	16,849.75		
1913	15,473.31		
1914	11,841.33		
Total 7 years	$ 117,489.84		
Average per year	16,784.26		
3 years purchase	$ 50,352.78	$ 50,000.00	being the amount taken

COMPLETE ACCOUNTING COURSE--PART II

Lecture 23

CURRENT LIABILITIES

Problem 50

The Martin Manufacturing Co., the United States Specialty Co., and the firm of Brown & Smith (a partnership) decide to consolidate under the name of the Progressive Manufacturing Co., with an authorized capital stock of $1,300,000 divided between 7% cumulative preferred stock of $500,000 and common stock of $800,000.

Under the agreement of purchase the vendors receive preferred stock (at par) for the net tangible assets and common stock for good-will. The issue of common stock to be based upon a sum equal to ten times the average annual earnings of the past five years, after allowing 7% interest on the capital invested. The following balance sheets reflect the financial position of the respective interests at the date of the consolidation. (Brown & Smith share profits or losses equally.)

ASSETS

	MARTIN MFG. CO.	UNITED STATES SPECIALTY CO.	BROWN & SMITH
Plant and Equipment	$102,000.00	$145,000.00	$ 95,500.00
Accounts and Notes Receivable	62,400.00	78,500.00	38,700.00
Inventory	48,500.00	61,500.00	43,650.00
Insurance Unexpired	1,250.00	1,700.00	800.00
Discount Paid in Advance	500.00	------	------
Cash	5,600.00	7,250.00	8,650.00
	$220,250.00	$293,950.00	$187,300.00

LIABILITIES

	MARTIN MFG. CO.	UNITED STATES SPECIALTY CO.	BROWN & SMITH
Capital Stock	$100,000.00	$150,000.00	$----------
Brown--Capital Account	------	------	72,000.00
Smith--Capital Account	------	------	42,000.00
Accounts and Notes Payable	36,100.00	86,075.00	70,230.00
Accrued Interest	------	850.00	1,220.00
Accrued Taxes	750.00	825.00	600.00
Labor Unpaid	1,400.00	2,200.00	1,250.00
Surplus	82,000.00	54,000.00	------
	$220,250.00	$293,950.00	$187,300.00

YEARLY EARNINGS

First Year	$ 37,500.00	$ 42,700.00	$ 33,400.00
Second Year	48,700.00	31,800.00	26,900.00
Third Year	43,400.00	39,600.00	27,350.00
Fourth Year	36,200.00	46,100.00	31,600.00
Fifth Year	59,200.00	39,800.00	30,750.00
	$225,000.00	$200,000.00	$150,000.00

Prepare the following:

(a) Opening journal entries on the books of the Progressive Manufacturing Co.

(b) Balance sheet after giving effect to the entries referred to in (a).

(c) Necessary journal entries to close the books of the respective vendors.

Problem 51

A share and investment corporation promotes a subsidiary corporation, and on January 1, 1918, subscribes $30,000 worth of stock, receiving also $70,000 stock as consideration for its services as promoter. Its promotion expenses amounted to $500. Sales of its holding in the subsidiary corporation are made as follows:

	STOCK	PRICE REALIZED
February	$ 5,000.00	$1,000.00
March	10,000.00	2,500.00
April	10,000.00	3,000.00
May	10,000.00	5,500.00
June	10,000.00	7,500.00
October	5,000.00	1,500.00

At December 31, 1918, the parent corporation's financial year closes, at which date it holds a balance of $50,000 stock, the current market price being $25 per $100 stock.

Give detailed ledger account, bringing down the balance at the figure at which it should be shown on the balance sheet, and assign your reasons for the valuation you place upon it.

QUESTIONS ON AUDITING

Question 126--As auditor, how would you satisfy yourself as to the accuracy of the liability Notes Payable as shown by the balance sheet?

Question 127--As auditor, how would you satisfy yourself as to the accuracy of the liability Accrued Taxes?

Question 128--Outline the procedure to be followed in the audit of the materials, supplies, and coal inventory of a small electric light company which generates its own electricity.

Question 129--In the course of an audit of a wholesale and retail butcher shop you find that all meats have been inventoried at the market price thereof at the date of inventory.

(a) Has the inventory been priced on the correct basis?
(b) How would you verify the prices used by the management?

Question 130--What is your understanding of the following:

(a) Mortgage bonds
(b) Collateral trust bonds
(c) Income bonds
(d) Debentures

Solution to Problem 46

JOURNAL ENTRIES ON THE BOOKS
OF THE UNIVERSAL MANUFACTURING CORPORATION

(1)		
Unissued Capital Stock	$2,000,000.00	
To--Authorized Issue Capital Stock		$2,000,000.00
To record authorized issue of capital stock, as per certificate of incorporation issued by the Secretary of State under date of..............		
(2)		
Real Estate and Buildings	680,000.00	
Plant	390,000.00	
Cash	15,000.00	
Bills Receivable	10,000.00	
Horses, Wagons, and Harness	4,000.00	
Office Furniture	1,000.00	
Good-Will	122,222.22	
To--Smith Manufacturing Co., Vendor		1,222,222.22
To record the purchase of the foregoing assets from the Smith Manufacturing Co., in accordance with contract dated................and resolutions adopted by the directors at a meeting held on.............		
(3)		
Real Estate and Buildings	327,000.00	
Plant	160,000.00	
Cash	3,000.00	
Bills Receivable	6,000.00	
Horses, Wagons, and Harness	3,000.00	
Office Furniture	1,000.00	
Good-Will	55,555.56	
To--Young Manufacturing Co., Vendor		555,555.56

To record the purchase from the Young Manufacturing Co. of the above assets as per contract dated............... and resolutions adopted by the directors at a meeting held on.........

(4)

Real Estate and Buildings	$126,000.00	
Plant	71,000.00	
Cash	1,000.00	
Horses, Wagons, and Harness	1,500.00	
Office Furniture	500.00	
Good-Will	22,222.22	
To--Star Manufacturing Co., Vendor		$222,222.22

To record the purchase of the foregoing assets from the Star Manufacturing Co. under the terms and conditions recited in the contract of sale dated ....and resolutions adopted by the directors at a meet-held on..............

(5)

Cash	100.00	
To--Unissued Capital Stock		100.00

Proceeds from sale of one share.

(6)

Smith Manufacturing Co., Vendor Account	22.22	
Young Manufacturing Co., " "	55.56	
Star Manufacturing Co., " "	22.22	
To--Cash		100.00

Payment in cash.

JOURNAL ENTRIES ON BOOKS OF STAR MANUFACTURING CO.

(1)

Profit and Loss Account	$301,000.00	
To--Real Estate and Buildings		$124,000.00
Plant		176,000.00
Horses, Wagons, and Harness		300.00
Office Furniture		700.00

To record the loss of the book over the appraisal value on the sale of the above assets to the Universal Manufacturing Corporation.

NOTE--Probably arose from the failure to provide for the accrued depreciation of plant, etc,

(2)

Good-Will	$ 22,222.22	
To--Profit and Loss Account		$ 22,222.22

To set up the asset of good-will, not heretofore carried on the books of the company.

(3)

Universal Manufacturing Corporation, Vendee Account	222,222.22	
To--Real Estate and Buildings		126,000.00
Plant		71,000.00
Cash		1,000.00
Horses, Wagons, and Harness		1,500.00
Office Furniture		500.00
Good-Will		22,222.22

To record sale of the above assets to the Universal Manufacturing Corporation, under the terms of the contract dated..............and per resolution adopted by the stockholders and directors at a meeting held on ....

(4)

Investment in Capital Stock of Universal Manufacturing Corporation	222,200.00	
Cash	22.22	
To--Universal Manufacturing Corporation, Vendee		222,222.22

Stock and cash received in payment for the assets sold to the Universal Manufacturing Corporation.

(5)

Bills Payable	50,000.00	
Accounts Payable	51,000.00	
To--Investment in Capital Stock of Universal Manufacturing Corporation		101,000.00

Liquidation of bills and accounts payable liabilities.

(6)

Capital Stock	400,000.00	
To--Investment in Capital Stock of Universal Manufacturing Corporation		121,200.00
Cash		22.22
Profit and Loss Account		278,777.78

To record final distribution of assets.

Solution to Problem 47

ENTRIES ON BOOKS OF WILSON AND WILSON

(1)

Unissued Preferred Stock	$ 60,000.00	
Unissued Common Stock	240,000.00	
To--Preferred Stock		$ 60,000.00
Common Stock		240,000.00

To record the authorized issue of capital stock as per certificate of incorporation issued by the Secretary of State dated ....

(2)

Subscriptions to Capital Stock	30,000.00	
To--Unissued Common Stock		30,000.00

To record subscriptions to $30,000 of the common stock of the Company, as follows:

Charles Wilson	$10,000.00
Robert Wilson	10,000.00
Henry Miller	10,000.00
	$30,000.00

(3)

Real Estate and Buildings	165,000.00	
Machinery and Fixtures	39,000.00	
Horses, Trucks, and Harness	4,500.00	
Patents	1,500.00	
Stocks and materials	20,000.00	
Notes and Loans Receivable	5,000.00	
Accounts Receivable	15,000.00	
To--Wilson & Wilson, Vendor Account		210,000.00
Notes Payable		6,000.00
Accounts Payable		34,000.00

To record the purchase from Charles and Robert Wilson of their respective interests in the foregoing net assets as per contract of sale dated............. and minutes of directors' meeting held on.............

(4)

Wilson and Wilson, Vendor Account	210,000.00	
To--Unissued Common Stock		210,000.00

To record issue of stock in payment for the assets referred to in the preceding entry.

(5)

Unissued First Mortgage 5% Bonds	$50,000.00	
To--Authorized Issue First Mortgage 5% Gold Bonds		$50,000.00
To record the authorized issue of first mortgage 5% gold bonds as per resolution adopted by the stockholders at a meeting held on..............		

(6)

Notes Payable	6,000.00	
Accounts Payable	34,000.00	
To--Unissued Preferred Stock		20,000.00
Unissued First Mortgage 5% Bonds		20,000.00
To record the liquidation of the notes and accounts payable liabilities as per agreement made with these creditors.		

ANSWERS TO QUESTIONS

Answer to Question 116--

1. Bookkeeper should prepare statement of each consignee's account.

2. Compare statement with ledger account.

3. Rubber stamped with request to examine the statement and notify auditor whether it is correct, or if desired, whether it is not correct.

4. Statement mailed by auditor in envelope bearing auditor's return address.

5. See that the consignments are carried in the inventory and not as accounts receivable.

6. See that the inventory price placed on these consignments is the same as that placed on similar goods in the stockroom. If there is nothing to indicate that the goods will be returned, or will not yield a fair price when sold, it is proper to add to the inventory price any expense, such as freight, insurance, etc., incurred by the consignor or consignee in connection with the shipment.

Answer to Question 117--The broker should not be stated as a debtor, but the item should be shown in the balance sheet as "Stock Sold, Not Yet Delivered," since payment cannot be enforced until the stock is delivered. In any case the actual debtor will not be the broker but his principal.

At the date of the balance sheet the stock still will be registered in the name of the company or its nominees. Therefore, the stock should be verified in the usual manner by inspection or by certificate. The broker's sold note should also be examined.

Answer to Question 118--

To the Board of Directors of the
Blank Manufacturing Company,
Chicago, Illinois.

Dear Sirs:

I have carefully considered the advisability of your company paying a return to the stockholders on their investment during the period of construction and have come to the conclusion that it is inadvisable to do so for the following reasons:

1. Capital is invested for the purpose of earning profits, and until property is placed on a revenue-producing basis (which cannot take place until the plant is complete as an operating unit) there can be no profits.
2. The legality of such a distribution might be questioned, since it is in effect a payment out of capital. This feature had best be referred to the company's counsel for a final opinion.
3. It is poor business policy to increase the capital investment for the purpose of providing funds to pay a return to stockholders during the construction period.

Some question may arise as to the proprietary of charging interest on BORROWED capital to construction since it is not considered proper to include interest on INVESTED capital as a charge to Property account.

Borrowed capital is a liability, and the interest thereon is a fixed charge and must be paid even though there are no profits. Capital stock is the proprietor's investment upon which no return can be paid until profit is made.

I shall be glad to furnish you any additional information that may be desired.

Very truly yours,

JOHN DOE,
Certified Public Accountant

Answer to Question 119--Coal in transit should be taken up and shown as "Coal in Transit" under the Inventory caption on the balance sheet and as "Unaudited Invoices" under the Current Liabilities caption. In case the client refuses to make the necessary adjustment the auditor's attitude would depend on the relative importance of the transaction. If the amount involved is (1) relatively small, (2) has no material bearing on the current liabilities, and (3) the market price is equal to or more than the cost price, the auditor may pass the point. In any other case it will be necessary to qualify the certificate attached to the balance sheet.

The coal received record contains the car numbers of each car received and unloaded. Comparison of the invoices with the freight bills will be of assistance in determining whether the coal stated to be "in transit" was actually received and included in the inventory.

Answer to Question 120--In the case of a retail department store with annual gross sales of $2,500,000, the auditor cannot assume responsibility for the inventory. The quantities cannot be tested, due to the fact that at the time of the audit the goods on hand at inventory date have been disposed of to a very large extent and new goods have been purchased. The inventories are so large that even a test check of extensions and footings is impracticable because of the expense incident to the proper performance of this work. In some cases it is customary to have an outside concern prove all extensions and footings. If this concern is reliable, a certificate as to the work done may be accepted. The prices are generally shown at selling price less the per cent of gross profit added when the goods were placed in stock. The clerical accuracy of such prices can be readily tested. On account of the character of the inventory, the market price is apt to be less than cost on a very large number of articles. The prices to be placed on seasonable goods, shelf-worn, or slow-moving goods is an extremely important point as to which a satisfactory solution is difficult to obtain.

REFERENCES:
Montgomery, pages 146-167
Wildman, pages 150-155

F. L. Barnes & Co.

Notes Payable - Bank Loans - $75,000.00 — 24

Notes Payable - Trade - $3,689.47

Accrued Interest on Notes Payable

Bank Loans Date	Bank	Discount or Demand		Due	Face	Accrued Interest
Dec. 11, 1918	Commerce National Bank	Discount	6%	60 days	$ 30,000.00	Prepaid
Nov. 30, 1918	First National Bank	Demand	5%	- -	15,000.00	$ 63.70 ^
Oct. 15, 1918	Fort Dearborn National Bank	Demand	6%	- -	10,000.00	126.58 ^
Dec. 31, 1918	First National Bank	Demand	6%	- -	20,000.00	- -
					$ 75,000.00 ^	

These notes are renewed at their expiration for similar periods and have thus been owing practically the entire year 1918.

Trade Notes Payable -

Date				Face	Accrued Interest
Nov. 18, 1918	Palmer Wolfram Mfg. Co.	90 day acceptance 6%		$ 2,047.50	14.67 ^
Dec. 5, 1918	H. G. Doerr & Sons	Trade acceptance 6%	60 days	1,641.97	7.12 ^
				$ 3,689.47 ^	$ 212.07 ^

F. L. Barnes & Co.

Vouchers Payable
Accounts Payable
Accrued State Taxes

25

Vouchers Payable — Voucher Number	Invoice Dated	Name	Terms	Amount
8751	Nov. 6	Claussen Lumber Co.	2/10 n/30	$ 1,465.20
8758	Nov. 4	James Garner Prtg. Co.	– –	264.80
8940	Dec. 12	Hobart Atkinson & Brady	– –	140.00
1	" 11	North Side Car Co.	cash	75.42
2	" 26	Amber Dexter Mfg. Co.	3/10 n/30	4,650.84
3	" 19	Acme Box Supply Co.	cash	3,470.49
4	" 4	Boardman Bros.	– –	572.12
5	Nov. 18	Jack Gylocki	– –	56.87
8	Dec. 12	Claussen Lumber Co.	2/10 n/30	4,368.84
8950	" 20	Fox Iron Co.	– –	10.00
				$ 15,074.58
Accounts Payable are "unaudited" vouchers—				
8951	Dec. 30	Edward P. Maloney	1/10 –	$ 340.50
	Dec. 31	Fred Clark & Bros.	– –	37.87
	Dec. 20	Chicago Towel Supply Co.	– –	48.20
	Nov. 30	F. E. Carter	2/10 n/45	77.30
	Dec. 26	Boardman Bros.	– –	476.12
	Dec. 24	Haider Stationery Stores	– –	56.65
	Dec. 24	North Side Car Co.	cash	238.67
				$ 1,275.31
From Petty Cash—				
1561	Dec. 12	Marshall Field & Co	– –	$ 78.80
1543	Dec. 31	City of Chicago	– –	17.50
1580	Dec. 30	Consumers Gas Co.		56.00
1575	Nov. 16	Nick Borlander		64.13
1581	Dec. 28	Tribune Co.		281.18
Accrued State Taxes—				
		Real Estate 1918 assessment	12½	$ 865.23
		Personal Property "	"	1,752.31
				$ 2,617.54

COMPLETE ACCOUNTING COURSE--PART II

Lecture 24

FUNDED DEBT; RESERVES

Problem 52

On January 1, 1918, A purchases the plant and business of B for $400,000, payable $100,000 cash; $150,000 January 1, 1919; $150,000 January 1, 1920; with interest on deferred payments at 6%. None of the book accounts or stock of finished goods on hand January 1, 1918, are included in the sale, but are specifically reserved by B. Of such the accounts receivable are $28,500, and finished goods, per inventory, $45,000. The agreement further stipulates that B shall operate the plant during the year 1918 and shall be reimbursed on January 1, 1919, for all funds advanced for supplies, expense, labor, or any other purpose in connection with the operation of the business during 1918, as shown by B's books. Such advances to be computed monthly and to bear interest from the last day of each month at 6% per annum to January 1, 1919. The profits of the business for the year 1918 to belong to A.

On December 31, 1918, B reports that inventory of finished goods on hand is $48,500. Expenses have been $284,000 and sales $350,000.

Condensed particulars of transactions are as follows:

	SALES	CASH COLLECTIONS	CASH ADVANCES	INTEREST DUE B
January	$ 15,000.00	$ 10,000.00	$ 10,000.00	$ 550.00
February	10,000.00	15,000.00	25,000.00	1,250.00
March	5,000.00	10,000.00	12,000.00	540.00
April	5,000.00	15,000.00	32,000.00	1,280.00
May	5,000.00	5,500.00	35,000.00	1,225.00
June	5,000.00	18,000.00	25,000.00	750.00
July	100,000.00	55,000.00	30,000.00	750.00
August	80,000.00	75,000.00	25,000.00	500.00
September	75,000.00	55,000.00	30,000.00	450.00
October	25,000.00	45,000.00	30,000.00	300.00
November	15,000.00	50,000.00	15,000.00	75.00
December	10,000.00	19,000.00	15,000.00	-----
	$350,000.00	$372,500.00	$284,000.00	$7,670.00

B presents the following statement to A on January 1, 1919, and requests settlement:

Sale of Plant and Business as per contract	$400,000.00
Less--Cash paid by A January 1, 1918	100,000.00
	$300,000.00
Interest at 6%, 1 year	18,000.00
Advanced by B monthly	284,000.00
Interest on Advances	7,670.00
	$609,670.00
Sales	350,000.00
Balance due B	$259,670.00
Of which $150,000 deferred to January 1, 1920	150,000.00
Due January 1, 1919	$109,670.00

A is not satisfied with statement and employs certified public accountants to investigate and report another basis of settlement. It is found that the accounts receivable December 31, 1918, are $6,000 and B has taken these, as well as the finished goods remaining on hand ($48,500) and claims both items belong to him. There are no liabilities.

Make statement for A, as requested, using your own methods. B's statement of interest on advances may be assumed to be correct in this question.

Problem 53

A land development company organizes with a capital stock of $30,000 of which $5,000 is issued for organization expenses.

The company purchases a tract of land for $50,000, giving a mortgage of $34,000 in part payment, and expends $13,000 for surveys, grading, etc., part in cash and part on book account. The company also erects two similar dwelling houses at a cost of $13,000--part in cash, part on book account, and part on sites within its land, representing a further value of $1,200. One of said houses is sold for $9,000.

The sales of lots amount to $30,200, including purchase money mortgages taken to secure part consideration on which interest to the amount of $750 is received, said mortgages being in turn pledged by the company for a loan.

The company pays $11,300 on account of the $34,000 mortgage, to release from incumbrance lots sold, and gives notes in settlement of book accounts to the sum of $4,000.

The cash transactions are as follows:

RECEIPTS		PAYMENTS	
Capital Stock	$25,000.00	Organization Expenses	$ 625.00
Purchasers' Accounts	20,825.00	Land Purchased	16,000.00
Loan	12,000.00	Surveying and Grading	6,000.00
Commissions and Fees	905.00	Accounts Payable	1,000.00
		Bills Payable	3,000.00
		Construction of Dwellings	7,000.00
		Mortgage Payable	11,300.00
		Interest	1,719.00
		Expense, Rent, Salaries, etc.	7,500.00
			$54,144.00
		Balance	4,586.00
	$58,730.00		$58,730.00

Inventory: Land $42,000, Dwelling $7,100.
Prepare ledger accounts, profit and loss accounts, and balance sheet.

QUESTIONS ON AUDITING

Question 131--What steps do you consider that an auditor should take in the verification of the following?

(a) First Mortgage 5% Bonds issued and outstanding, $250,000
(b) Preferred Stock issued and outstanding, $200,000

Question 132--In the examination of the accounts of an important railroad, it appears that none of the invoices and material purchased appear on the company's books until they have been approved by the purchasing agent and division superintendents, although the various storekeepers' reports show that much of the material and supplies has actually been received.

How would you deal with such a condition and determine the real position of the railroad with respect to purchases not taken up on the voucher register?

Question 133--The Bristol Manufacturing Co. issued and sold on the 1st of January, 1918, to A and B, 100 (50 to each at the same price) first mortgage bonds of $500 each, bearing interest at 4% per annum, and received $48,000 in cash. What records of the transaction should be made, and in what books?

Question 134--How should the following items be dealt with in the accounts of a company:

(a) Discount on bonds or stock
(b) Premium on stock or bonds
(c) Common stock issued as a bonus with the sale of preferred stock

How would you audit the foregoing transactions?

Question 135--A charitable institution receives annual subscriptions and donations and employs a canvasser who has to induce persons to become subscribers and who is also authorized to receive subscriptions and donations.

State what you consider the best system of bookkeeping to guard against peculation and what regulations you would lay down for the conduct of the financial affairs of the institution.

Solution to Problem 48

Exhibit I

WHITE MANUFACTURING COMPANY
BALANCE SHEET, DECEMBER 31, 1918

ASSETS		
CAPITAL ASSETS (subject to accrued depreciation not provided for):		
Real Estate	$ 24,000.00	
Buildings	36,783.11	
Mach. & Equip.	87,105.99	$147,889.10
CURRENT ASSETS:		
Inventories of:		
Raw Material	$ 69,075.23	
Work in Progress	14,908.17	
Finished Product	27,575.50	
	$111,558.90	
Customers' Accts.	96,798.93	
Notes Receivable	21,678.03	
Cash	10,751.02	240,786.88
DEFERRED CHARGES:		
Insurance Unexpired		593.44
		$389,269.42

LIABILITIES		
CAPITAL STOCK:		
Issued and Outstanding 2,000 shares Par Value $100		$200,000.00
CURRENT LIABILITIES:		
Notes Payable	$ 45,000.00	
Accts. Payable	39,632.95	
Dividend Payable Jan. 15, 1919	6,000.00	90,632.95
SURPLUS:		
Balance at Jan. 1, 1918	$ 69,304.48	
Add--Surplus Net Profits for year ending Dec. 31, 1918 (Exhibit II)	35,331.99	
	$104,636.47	
Deduct--Dividends	6,000.00	
Balance at Dec. 31, 1918 (subject to accrued depreciation not provided for)		98,636.47
		$389,269.42

Exhibit II

WHITE MANUFACTURING COMPANY
STATEMENT OF PROFITS AND INCOME
FOR YEAR ENDING DECEMBER 31, 1918

		AMOUNT	PER CENT.
SALES		$620,033.89	
Deduct--Discounts on Sales	$19,419.87		
Allowances on Sales	13,081.14		
Freight	10,439.23	42,940.24	
NET PROCEEDS FROM SALES		$577,093.65	100.00
DEDUCT--Cost of Goods Sold (Exhibit III)		514,996.90	89.24
GROSS PROFIT ON SALES		$ 62,096.75	10.76
ADD--Miscellaneous Income:			
Interest Received	$ 2,909.45		
Discounts on Purchases	6,487.11	9,396.56	1.63
TOTAL PROFITS AND INCOME FROM ALL SOURCES		$ 71,493.31	12.39
DEDUCT--SELLING AND GENERAL EXPENSES:			
Selling Expenses (Exhibit IV)	$19,377.82		3.36
General Expenses (Exhibit V)	12,000.00		2.08
		31,377.82	5.44
NET PROFITS FROM OPERATION		$ 40,115.49	6.95
DEDUCT--Interest Paid		4,783.50	.83
SURPLUS NET PROFITS (Exhibit I)		$ 35,331.99	6.12

Exhibit III

WHITE MANUFACTURING COMPANY
STATEMENT OF COST OF MANUFACTURE AND GOODS SOLD
YEAR ENDING DECEMBER 31, 1918

MATERIALS:			
Inventory of Raw Material at January 1, 1918		$ 38,983.45	
Purchases	$293,839.18		
Freight-In	18,067.50	311,906.68	
		$350,890.13	
LESS--Inventory at December 31, 1918		69,075.23	$281,814.90
WAGES			160,511.92
FACTORY EXPENSES:			
Superintendent's Salary		$ 3,000.00	
Light, Heat, and Power		2,908.38	
Insurance		810.54	
Repairs and Maintenance		22,037.73	
Sundry Factory Expenses		6,093.17	34,849.82
			$477,176.64
DEDUCT--WORK IN PROGRESS INVENTORY VARIATION:			
Inventory at January 1, 1918		----------	
Inventory at December 31, 1918		$14,908.17	14,908.17
COST OF FINISHED PRODUCT MANUFACTURED			$462,268.47
ADD--FINISHED PRODUCT INVENTORY VARIATION:			
Inventory at January 1, 1918		$ 80,303.93	
Inventory at December 31, 1918		27,575.50	52,728.43
COST OF GOODS SOLD (Exhibit II)			$514,996.90

Exhibit IV

WHITE MANUFACTURING COMPANY
STATEMENT OF SELLING EXPENSES
YEAR ENDING DECEMBER 31, 1918

Salesmen's Salaries and Commissions	$11,425.50
Salesmen's Traveling Expenses	6,638.19
Bad Debts	1,314.13
TOTAL SELLING EXPENSES (Exhibit II)	$19,377.82

Exhibit V

WHITE MANUFACTURING COMPANY
STATEMENT OF GENERAL AND ADMINISTRATIVE EXPENSES
YEAR ENDING DECEMBER 31, 1918

Officers' Salaries	$12,000.00
TOTAL GENERAL AND ADMINISTRATIVE EXPENSES (Exhibit II)	$12,000.00

Solution to Problem 49

JOURNAL ENTRIES

(1)

Cash		$ 3,487.11	
First Mortgage 6% W Ry. Co. Bonds		75,000.00	
6% Mortgage Loans		40,000.00	
Preferred Stock (at par) Allen Mfg. Co.		125,000.00	
Notes Receivable		30,000.00	
Household Furniture		1,000.00	
Accrued Interest as follows:		1,475.00	
Bonds	$ 750.00		
Loans	600.00		
Notes Receivable	125.00		
	$1,475.00		
To--Estate Account			$263,962.11
Sundry Liabilities			12,000.00

To record inventory of estate of A as filed in probate court on.........

(2)

Estate Account	1,000.00	
To--Household Furniture		1,000.00

To record transfer of household furniture to A's widow in accordance with the terms of the will.

(3)

Preferred Stock	5,000.00	
To--Estate Account		5,000.00

To transfer profit on sale of Allen Manufacturing Co. preferred stock.

A'S ESTATE
SUMMARY OF CASH TRANSACTIONS
FROM JUNE 1 TO OCTOBER 1, 1918

PARTICULARS	PRINCIPAL	INCOME	PARTICULARS	PRINCIPAL	INCOME
Cash on Hand and in Bank June 1, 1918	$ 3,487.11	$--------	Funeral Expenses	$ 1,200.00	$--------
			Probate Court Costs	1,500.00	--------
Interest Collected on:			Attorney's & Accountant's Fees	1,200.00	--------
Loans	600.00	600.00	Sundry Liabilities	12,000.00	--------
Bonds	750.00	1,500.00	Legacies:		
			William Brown	3,000.00	--------
Preferred Stock--Allen Mfg. Co.	130,000.00	--------	John Smith	2,000.00	--------
			A. R. Jones	1,000.00	--------
			Payment to Widow of Income collected to October 31, 1918	--------	2,100.00
			Balance	112,937.11	--------
	$134,837.11	$2,100.00		$134,837.11	$2,100.00

(............) EXECUTOR OF A'S ESTATE
CHARGE AND DISCHARGE STATEMENT
FROM JUNE 1, 1918, TO OCTOBER 1, 1918

CHARGE

ESTATE AT DEATH OF TESTATOR,		
JUNE 1, 1918:		
Cash on Hand		$ 350.00
Cash in Bank		3,137.11
First Mortgage 6% W Ry. Co. Bonds		75,000.00
6% Mortgage Loans		40,000.00
Preferred Stock		125,000.00
Notes Receivable		30,000.00
Household Furniture		1,000.00
Accrued Interest on:		
Bonds	$750.00	
Loans	600.00	
Notes Receivable	125.00	1,475.00
		$275,962.11
LESS--Sundry Liabilities		12,000.00
NET		$263,962.11
PROFIT ON SALE OF PREFERRED STOCK		5,000.00
INCOME COLLECTED:		
Interest on:		
Bonds	$1,500.00	
Loans	600.00	2,100.00
		$271,062.11

DISCHARGE

PAYMENTS OUT OF PRINCIPAL:			
Legacies:			
William Brown	$3,000.00		
John Smith	2,000.00		
A. R. Jones	1,000.00	$6,000.00	
Funeral Expenses		1,200.00	
Probate Court Costs		1,500.00	
Attorney's & Accountant's Fees		1,200.00	
Household Furniture		1,000.00	$ 10,900.00
INCOME PAID TO WIDOW PER TERMS OF WILL			$ 2,100.00
ESTATE AT OCTOBER 31, 1918:			
First Mortgage 6% W Ry. Co. Bonds			$ 75,000.00
6% Mortgage Loans			40,000.00
Notes Receivable			30,000.00
Uncollected Accrued Interest at June 1, 1918			125.00
Cash			112,937.11
Total Estate			$258,062.11
			$271,062.11

In case the widow died October 31, 1918, no change need be made in respect of the cash transactions, but the following additional journal entries would be required:

(4)

Accrued Interest	$ 375.00	
To--Income		$ 375.00
To take up interest accrued from October 1 to October 31 on first mortgage 6% W Ry. Co. bonds.		

(5)

Accrued Interest	400.00	
To--Income		400.00
To take up interest accrued from September 1 to October 31 on 6% mortgage loans.		

(6)

Accrued Interest	625.00	
To--Income		625.00
To take up interest on notes receivable at 5% from June 1, 1918, to October 31, 1918.		

(7)

Income	1,400.00	
To--Estate of A's Widow		1,400.00
To transfer income accrued to A's widow at October 31, 1919.		

JOHN DOE, EXECUTOR OF A'S ESTATE
CHARGE AND DISCHARGE STATEMENT
FROM JUNE 1, 1918, TO OCTOBER 31, 1918

I CHARGE MYSELF AS FOLLOWS:

1. ESTATE OF A AT JUNE 1, 1918, viz:		
Cash on Hand		$ 350.00
Cash in Bank		3,137.11
First Mortgage 6% W. Ry. Co. Bonds		75,000.00
6% Mortgage Loans		40,000.00
Preferred Stock		125,000.00
Notes Receivable		30,000.00
Household Furniture		1,000.00
Accrued Interest on:		
Bonds	$750.00	
Loans	600.00	
Notes Receivable	125.00	1,475.00
		$275,962.11
LESS--Sundry Liabilities		12,000.00
NET		$263,962.11
2. PROFIT ON SALE OF PREFERRED STOCK		5,000.00
3. INCOME COLLECTED:		
Int. on Bonds	$1,500.00	
Int. on Loans	600.00	2,100.00
4. INCOME ACCRUED:		
Int. on Bonds	$ 375.00	
Int. on Loans	400.00	
Int. on Notes Rec.	625.00	1,400.00
		$272,462.11

I CREDIT MYSELF AS FOLLOWS:

1. PAYMENTS OUT OF PRINCIPAL:		
Funeral Expenses	$1,200.00	
Probate Court Costs	1,500.00	
Attorney's & Accountant's Fees	1,200.00	
Household Furniture	1,000.00	$ 4,900.00
2. LEGACIES PAID:		
Wm. Brown	$3,000.00	
John Smith	2,000.00	
A. R. Jones	1,000.00	6,000.00
3. INCOME PAID TO WIDOW		2,100.00
4. ACCRUED INCOME DUE ESTATE OF A'S WIDOW		1,400.00
5. ESTATE OF A AT OCTOBER 31, 1918, viz:		
Cash	$112,937.11	
First Mortgage 6% W Ry. Co. Bonds	75,000.00	
6% Mortgage Loans	40,000.00	
Notes Rec.	30,000.00	
Uncollected Accrued Interest at June 1, 1918	125.00	258,062.11
		$272,462.11

ANSWERS TO QUESTIONS

Answer to Question 121--

The books and accounts to be opened are as follows:

1. Books to be kept:
   - Ledger
   - Journal
   - Cash book
2. Accounts to be opened:
   - Real Estate
   - Share in Partnership
   - Shares of Stock
   - Household Furniture
   - Cash at Bankers
   - Estate
   - Income

The accountant should obtain a copy of the appraisal as filed in the probate court and acquaint himself with all provisions in the will affecting the accounts. He must apportion all receipts as between principal and income, and for this purpose a cash book providing separate columns on each side for principal and income will be of advantage.

Answer to Question 122--The auditor should call for a certified copy of the inventory filed in the probate court. Comparison of this inventory with the opening journal entry would be a satisfactory verification.

Answer to Question 123--

CASH RECEIPTS

DATE	FROM WHOM	PARTICULARS	FOLIO	PRINCIPAL	INCOME

CASH DISBURSEMENTS

DATE	TO WHOM	PARTICULARS	FOLIO	PRINCIPAL	INCOME

Answer to Question 124--

(a) Interest accrues from day to day. Consequently all interest from bonds accrued up to and including the date of death would be principal; all interest accrued subsequent thereto should be credited to income.

(b) A dividend becomes income to the stockholder on the day it is declared. Consequently, all dividends declared up to and including the date of death would be principal; dividends declared after the date of death should be credited in toto to income.

The rule of law in respect of stock dividends is unsettled. In some jurisdictions stock dividends are not differentiated from other dividends, and the date of declaration determines whether it is principal or income. In other jurisdictions it has been held that stock dividends should be apportioned between principal and income. (See Howe, "American Law of Principal and Income.")

(c) There is no clear rule of law as to the apportionment of rent between principal and income. In some jurisdictions the courts hold that the date the rent falls due is the determining factor. In such cases rent due on or before the date of death would be principal irrespective of whether such rents be prepaid or accrued. In other jurisdictions the courts hold that rents should be apportioned over the period covered by the payments. In such cases rents accrued prior to the date of death would be principal irrespective of whether the rental is paid prior or subsequent thereto.

Answer to Question 125--Under the last will and testament of Henry Rogers the widow is entitled to all income from the estate during her lifetime. Whether this income is actually received in cash during her lifetime is immaterial; the widow's estate would be credited with:

1. All interest accrued on bonds from March 16 to April 15, inclusive.
2. All dividends declared on stocks from March 16 to April 15, inclusive, unless in this jurisdiction the courts should require the apportionment of stock dividends.
3. All rents paid from March 16 to April 15, inclusive, unless in this jurisdiction the courts should require the apportionment of rents.

REFERENCES:

Montgomery, pages 157-158; 181-185; 194-199; 388-389
Wildman, pages 148-150

F. L. Barnes & Co.

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Federal Taxes Accrued

Invested Capital –			
Capital Stock Jan. 1, 1918		$ 230,000.00	
Stock sold during year ($\frac{146}{365}$ × $20,000)		8,000.00	$ 238,000.00
Surplus – Balance Jan. 1, 1918		$ 27,342.99	
Add – Back Non-deductible reserves			
Sinking Fund Reserve		10,000.00	
Reserve for Inventory		1,634.58	
Reserve for Bad Debts		1,028.90	
Federal Taxes Accrued		1,000.00	
		$ 41,006.47	
Less – Federal Taxes paid ($\frac{200}{365}$ × $1,254.71)	$ 687.51		
Dividends paid ($\frac{334}{365}$ × $11,500)	10,523.29	11,210.80	29,795.67
			$ 267,795.67
Net Income for Year –			
Per Books – as adjusted			$ 22,719.29
Add – Net Additions to Reserves –			
Reserve for Inventory (Credit)		$ 1,558.18	
Reserve for Bad Debts (Debit)		526.50	
		$ 1,031.68	
Less – Liberty Bond Interest		225.50	806.18
			$ 23,525.47

Inasmuch as the net Income is less than 8% of the invested capital + $3,000.00, the war profits and excess profits taxes will not apply.

Normal Tax –	
Net Income as above	$ 23,525.47
Less – Specific Exemption	2,000.00
Amount subject to 12% Tax	$ 21,525.47
12% of the latter is	$ 2,583.06
Amount Reserved	$ 2,600.00

The above figures may be altered somewhat owing to the absence of regulations at this date (Feb. 15, 1919). The investment in the D. B. Story Mfg. Co. may be ruled an inadmissable asset if a separate income tax return is allowed. Under such circumstances the above amount ($2600) will represent the maximum obligation.

F. L. Barnes & Co.

First Mortgage 6% Bonds

The issue was authorized as of Jan. 1, 1917 for the purpose of retiring a like amount of notes outstanding in favor of F. L. Barnes. The present ownership of bonds is as follows—

F. L. Barnes	#A	12-51	inclusive	$ 40,000.00
James B. Carey	A	53-62	"	10,000.00
Ford Goodwie	A	63-82	"	20,000.00
H. E. Barnes	A	83-87	"	5,000.00
Myron T. Barnes	A	88-95	"	8,000.00
H. E. Barnes	A	96-97	"	2,000.00
Mrs. F. L. Barnes	A	98-102	"	5,000.00
Mrs. M. T. Barnes	A	103-112	"	10,000.00
				$ 100,000.00

For excerpts of Trust Deed see Sinking Fund assets

COMPLETE ACCOUNTING COURSE--PART II

Lecture 25

CAPITAL STOCK; SURPLUS; PROFIT AND LOSS ACCOUNT

Problem 54

From the following trial balance abstracted from the books of the Edwards Manufacturing Co. at December 31, 1918, prepare a balance sheet as of that date with a relative statement of profits:

PARTICULARS	DEBITS	CREDITS
Preferred Stock		$ 100,000.00
Common Stock		125,000.00
First Mortgage 6% Gold Bonds		100,000.00
Surplus at January 1, 1918		42,493.98
Land	$ 23,500.00	
Buildings	133,127.11	
Machinery and Equipment	64,133.34	
Tools and Running Gear	13,113.78	
Notes Receivable	19,422.03	
Customers' Accounts	93,183.27	
Sundry Debtors	1,378.34	
Notes Payable		45,670.00
Unpaid Audited Vouchers		33,198.34
Matured Bond Interest Coupons		3,425.00
Inventory Raw Materials at January 1, 1918	23,083.27	
Inventory Work in Progress at January 1, 1918	10,100.00	
Purchases of Raw Materials	284,311.93	
Wages	149,327.31	
Light, Heat, and Power	2,483.11	
Sales		583,111.37
Traveling Expenses (Miscellaneous)	1,983.50	
Discounts on Sales	18,343.11	
Discounts on Purchases		3,118.93
Freight-Inward	19,087.27	
Allowances on Sales	11,832.50	
Insurance--one-half Manufacturing and one-half Selling	2,450.00	
Factory Expenses	3,350.31	
Superintendent's Salary	2,400.00	
Bad Debts	937.11	
Royalties	3,307.50	
Officers' Salaries	11,500.00	
Salesmen's Salaries and Commissions	10,375.50	
Freight-Outward	12,397.50	

Salesmen's Traveling Expenses	3,983.21	
Cash (Banks)	6,908.73	
Cash (Deposited with Fiscal Agent)	3,425.00	
Inventory of Finished Product January 1, 1918	78,111.30	
Repair and Maintenance Expenditures	19,083.27	
Interest Paid	9,398.32	
	$1,036,017.62	$1,036,017.62

The following items should be considered in preparing the balance sheet with the relative statement of profits:

1. Insurance Unexpired		$ 450.00
2. Accrued Interest on Bonds and Notes Payable		1,125.00
3. Taxes Accrued of		2,234.83
4. Inventory of:		
a) Raw Materials	$24,308.14	
b) Work in Process	33,987.32	
c) Finished Products	40,398.50	
5. Wages Accrued		13,134.87

6. Provide Depreciation for the year on the balance given in the Trial Balance upon the basis of the following rates:

Buildings	2½% per annum
Machinery and Equipment	10% per annum
Tools and Running Gear	10% per annum

Problem 55

A single-entry set of books for 1918 is sent to you with an order to state a Profit and Loss account for the year and a balance sheet at December 31. The starting capital was $34,500.

The Accounts Receivable	Jan. 1	$26,500.00	Dec. 31	$44,000.00
" Accounts Payable	" "	7,500.00	" "	9,750.00
" Merchandise	" "	8,500.00	" "	9,500.00
" Plant and Machinery	" "	10,000.00	" "	10,000.00
" Furniture & Fixtures	" "	700.00	" "	700.00

A Summary of the cash book for the year shows as follows:

RECEIVED	
Accounts Receivable	$30,000.00
Capital paid in	2,500.00
DISBURSED	
Bank Overdraft January 1	$ 3,700.00
Accounts Payable	12,500.00
General Expense	5,000.00
Wages	7,750.00
Personal Account	1,500.00

leaving a bank account of $2,000, and currency on hand $50.

Provide 5% interest on capital, disregarding additions during the year and personal drafts, deducting 10% for plant and machinery depreciation, 5% for furniture and fixtures, and 5% for bad debts.

Problem 56

A company with head office in Chicago and factory at South Bend, Indiana, conducts three selling branches in New York, San Francisco, and Montreal, which are supplied with goods from the factory, the invoices being sent out from the head office.

The branches keep their own sales ledgers, send out monthly statements to customers, and receive cash against their ledger accounts, which they remit weekly to Chicago.

All branch expenses, including salaries and wages, are paid by the branches from petty cash accounts, kept at a fixed balance of $500, by draft on head office.

The following information is supplied by the branches at December 31, 1918, summarizing the transactions of the previous six months;

	NEW YORK	SAN FRANCISCO	MONTREAL
Rents and Taxes Paid	$ 200.00	$ 175.00	$ 75.00
Sales for 6 months to December 31, 1918	12,500.00	11,800.00	10,225.00
Salaries and Wages	1,650.00	1,520.00	1,600.00
Return Sales	200.00	100.00	250.00
Allowances to Customers	50.00	40.00	30.00
Bad Debts	--------	125.00	60.00
Cash Sales	6,250.00	5,380.00	6,100.00
Cash Received from Customers on Ledger Accounts	10,850.00	10,260.00	9,150.00
Debtors, July 1, 1918	5,820.00	6,140.00	7,240.00
Debtors, December 31, 1918	7,220.00	7,415.00	7,975.00
Petty Cash on Hand, July 1, 1918	500.00	500.00	500.00
Petty Cash on Hand, December 31, 1918	500.00	500.00	500.00
Stock, July 1, 1918	3,450.00	3,820.00	3,650.00
Stock, December 31, 1918	4,300.00	4,720.00	4,500.00
Goods Received from Head Office Factory	11,500.00	10,240.00	10,350.00

From these details prepare branch accounts as they should appear in the head office books and draw up a final general trial balance with branch profit and loss accounts.

QUESTIONS ON AUDITING

Question 136--Under what circumstances may a company reduce its capital stock? Assuming a reduction of capital stock to have taken place, what special duties would fall upon you as auditor on the occasion of the first audit thereafter?

Question 137--In the course of your audit of a company you find that certain commissions have been paid for underwriting the shares issued to the public, and other commissions for placing shares. Under what circumstances would you be prepared to pass these payments as in order, and how would you vouch them?

Question 138--State how, in your opinion, the following items should be distributed in the accounts:

(a) Purchase by the Rapid City R. R. Co. of locomotives, passenger cars, freight train cars, and other equipment of a value of $100,000
(b) Extraordinary repairs to machinery, tools, and equipment, tending to prolong the life of the equipment, $53,017.44

How would you audit the foregoing transactions?

Question 139--In the course of your audit you find the following items included under the heading of Plant and Machinery:

(a) Interest on bank loans, $3,700
(b) Legal and other expenses incurred in connection with acquisition of certain property, $1,000
(c) Consulting engineer's salary, $7,500

If engaged by the president of the company, what would be your attitude in respect of the foregoing items?

Would you alter or modify your position if the audit were being made on behalf of a bond house which expected to fund "80% of the cash expenditures for additions and betterments"?

Question 140--How would you as an auditor undertake to satisfy yourself in regard to the correctness of journal entries?

Solution to Problem 50

JOURNAL ENTRIES TO OPEN BOOKS
OF THE PROGRESSIVE MANUFACTURING CO.

(1)

Preferred Stock Unissued	$500,000.00	
Common Stock Unissued	800,000.00	
To--Preferred Stock		$500,000.00
Common Stock		800,000.00
To record the authorized issue of capital stock per charter granted by the State of.............		

(2)

Plant and Equipment	$342,500.00	
Accounts and Notes Receivable	179,600.00	
Inventory	153,650.00	
Insurance Unexpired	3,750.00	
Discount Paid in Advance	500.00	
Cash	21,500.00	
Good-Will	800,000.00	
To--The Martin Manufacturing Co., Vendor		$504,600.00
United States Specialty Co., Vendor		461,200.00
Brown & Smith, Vendor		334,200.00
Accounts & Notes Payable		192,405.00
Interest Accrued		2,070.00
Taxes Accrued		2,175.00
Labor Unpaid		4,850.00

Assets acquired and liabilities assumed in the acquisition of the business of The Martin Manufacturing Co., United States Specialty Co., and Brown & Smith, respectively, under the agreements with the vendors dated..............

	MARTIN MFG. CO.	U.S. SPEC. CO.	BROWN & SMITH	TOGETHER
ASSETS				
Plant and Equipment	$102,000.00	$145,000.00	$ 95,500.00	$ 342,500.00
Accounts and Notes Receivable	62,400.00	78,500.00	38,700.00	179,600.00
Inventory	48,500.00	61,500.00	43,650.00	153,650.00
Insurance Unexpired	1,250.00	1,700.00	800.00	3,750.00
Discount Paid in Advance	500.00	--------	--------	500.00
Cash	5,600.00	7,250.00	8,650.00	21,500.00
Good-Will	322,600.00	257,200.00	220,200.00	800,000.00
	$542,850.00	$551,150.00	$407,500.00	$1,501,500.00

	MARTIN MFG. CO.	U.S. SPEC. CO.	BROWN & SMITH	TOGETHER
LIABILITIES				
Accounts and Notes Payable	$ 36,100.00	$ 86,075.00	$ 70,230.00	$ 192,405.00
Interest Accrued	--------	850.00	600.00	2,175.00
Taxes Accrued	750.00	825.00	1,220.00	2,070.00
Labor Unpaid	1,400.00	2,200.00	1,250.00	4,850.00
	$ 38,250.00	$ 89,950.00	$ 73,300.00	$ 201,500.00
Net Assets	504,600.00	461,200.00	334,200.00	1,300,000.00
	$542,850.00	$551,150.00	$407,500.00	$1,501,500.00

(3)

The Martin Manufacturing Co., Vendor	$504,600.00	
United States Specialty Co., Vendor	461,200.00	
Brown & Smith, Vendor	334,200.00	
To--Preferred Stock Unissued		$500,000.00
Common Stock Unissued		800,000.00

To record the issue of preferred and common stock to The Martin Manufacturing Co., United States Specialty Co., and Brown & Smith, respectively, under the terms and conditions of the agreement dated ...., preferred stock to be issued for the <u>net</u> tangible assets and common stock for the good-will.

	COMMON STOCK	PREFERRED STOCK	TOGETHER
The Martin Manufacturing Co.	$322,600.00	$182,000.00	$ 504,600.00
United States Specialty Co.	257,200.00	204,000.00	461,200.00
Brown & Smith	220,200.00	114,000.00	334,200.00
	$800,000.00	$500,000.00	$1,300,000.00

THE PROGRESSIVE MANUFACTURING CO.
BALANCE SHEET AT THE COMMENCEMENT OF THE BUSINESS

ASSETS

CAPITAL ASSETS:		
Plant and Equipment	$342,500.00	
Good-Will	800,000.00	$1,142,500.00
CURRENT ASSETS:		
Inventories	$153,650.00	
Accounts and Notes Receivable	179,600.00	
Cash	21,500.00	354,750.00
DEFERRED CHARGES TO INCOME:		
Insurance Unexpired	$3,750.00	
Discount Paid in Advance	500.00	4,250.00
		$1,501,500.00

LIABILITIES

CAPITAL STOCK--Authorized and Issued:		
Preferred Shares	$500,000.00	
Common Shares	800,000.00	$1,300,000.00
CURRENT LIABILITIES:		
Accounts and Notes Payable	$192,405.00	
Interest Accrued	2,070.00	
Taxes Accrued	2,175.00	
Labor Unpaid	4,850.00	201,500.00
		$1,501,500.00

ENTRIES UPON THE BOOKS OF THE MARTIN MANUFACTURING CO.

(1)

Good-Will		$322,600.00	
To--Surplus Account			$322,600.00
To set up the value of good-will as arrived at in the following manner, being the basis at which it is to be taken over by The Progressive Manufacturing Co., under the agreement dated..............			
The average annual earnings for the last five years amounted to		$ 45,000.00	
LESS--Interest at 7% per annum on the capital investment, viz:			
Capital Stock	$100,000.00		
Surplus	82,000.00		
	$182,000.00		
7% thereof is		12,740.00	
		32,260.00	
Ten times this amount		$322,600.00	

(2)

The Progressive Manufacturing Co., Vendee	504,600.00	
Accounts and Notes Payable	36,100.00	
Taxes Accrued	750.00	
Labor Unpaid	1,400.00	
To--Good-Will		322,600.00
Plant and Equipment		102,000.00
Accounts and Notes Receivable		62,400.00
Inventory		48,500.00
Insurance Unexpired		1,250.00
Discount Paid in Advance		500.00
Cash		5,600.00
To record assets sold to and liabilities assumed by The Progressive Manufacturing Co. under bill of sale dated...........		

(3)

The Progressive Manufacturing Co.:		
Preferred Stock	$182,000.00	
Common Stock	322,600.00	
To--The Progressive Manufacturing Co., Vendee Account		$504,600.00

Preferred and common stock received in payment from The Progressive Manufacturing Co. for the net assets sold to that company under the agreement dated ....

(4)

Surplus Account	404,600.00	
To--Dividend Payable		404,600.00

Dividend of 404.6% declared to the stockholders and payable in the stock received from the sale of the business to the Progressive Manufacturing Co.

(5)

Dividend Payable	404,600.00	
Capital Stock	100,000.00	
To--The Progressive Manufacturing Co.:		
Preferred Stock		182,000.00
Common Stock		322,600.00

Payment of dividend and the return of the original capital investment, per resolution adopted by the board of directors at a meeting held on............., 1919.

Similar entries should be made on the books of the United States Specialty Co. and Brown & Smith, respectively, except that in the case of the partnership the capital profit arising from the sale of the good-will should be credited direct and in equal proportions to Brown's and Smith's Capital accounts; in that case entry 4 (as above) would not be required; moreover, the "Dividend Payable" feature of entry 5 would be eliminated, but in all other respects the same entries would be made.

Solution to Problem 51

STOCK IN SUBSIDIARY COMPANY

DEBITS					CREDITS			
1918		PARTICULARS	PAR VALUE	COST	1918	PARTICULARS	PAR VALUE	AMOUNT
Jan.	1	Stock Subscribed for	$ 30,000.00	$30,000.00	Feb.	Stock sold	$ 5,000.00	$ 1,000.00
Jan.	1	Stock received in payment for services as promoter*	70,000.00	--------	Mar.	" "	10,000.00	2,500.00
					Apr.	" "	10,000.00	3,000.00
					May	" "	10,000.00	5,500.00
					June	" "	10,000.00	7,500.00
					Oct.	" "	5,000.00	1,500.00
		Promotion expenses		500.00				$21,000.00
Dec.	31	Profit (extraordinary profit)		3,000.00		Balance--Estimated realizable value of stock unsold at December 31	50,000.00	12,500.00
			$100,000.00	$33,500.00			$100,000.00	$33,500.00

* A memorandum entry in the ledger account.

ANSWERS TO QUESTIONS

Answer to Question 126--The unpaid notes as shown by the notes payable register should be footed, and the total thereof should agree with the balance sheet figure. It would be advisable to analyze the Interest Paid Account in order to ascertain whether interest is being paid on notes not listed in the register, or whether notes (probably accommodation paper) not listed were discounted. The auditor cannot be held responsible for notes which may be issued without any record appearing on the books of account, as for instance, the issuance of a company note by an officer who pays the interest personally, or has the interest check charged to his personal account. It may be advisable to circularize the parties from whom funds are ordinarily borrowed and to obtain a certificate from the financial officers as to the aggregate amount of notes outstanding. The names of the officers having authority to sign notes can be obtained from the minute book.

Answer to Question 127--The auditor should ascertain the tax period, whether the company's method of accruing taxes is satisfactory as shown by past experience, whether any changes have occurred in the assessable property or tax rate which would necessitate an adjustment of the amount accrued periodically during the period under review. Where the fiscal period coincides with the tax period the amount of accrued taxes as shown by the balance sheet should represent the entire tax assessment for the year. In some cases it is advisable to write to the tax official for a statement of the amount of taxes due to date, and the amount and rate of the next assessment.

Answer to Question 128--The procedure to be followed in the audit of the materials, supplies, and coal inventory of a small electric light company generating its own electricity is fairly simple.

1. Obtain the original inventory sheets. See that they are properly initialed by the various parties taking, pricing, extending, and footing the inventory. Also obtain a certificate from the manager as to the correctness of the inventory as a whole.

2. Quantities. In case stores records are kept compare the quantities shown by the inventory sheets with such records. If discrepancies are disclosed, ascertain the probable cause. In case the inventory sheets contain the quantities shown by the stores records, ascertain when the last physical inventory was taken and how the stores records were adjusted at that time. Prepare a comparative inventory sheet showing the quantities, prices, and amounts of a representative list of items.

3. Prices. Cost is generally adopted as the price basis. Inasmuch as such inventories are held for use and not for sale it is considered permissible to use cost as the price basis although the rule of cost or market, whichever is the lower, is the most conservative practice. To verify the prices used, compare same with the purchase invoices. Calculate the cost per ton of coal used, and compare same with the inventory price.

4. Extensions. It is usually practical to make a thorough test of the extensions.

5. Footings. It is usually practicable to prove the footings in toto.

Answer to Question 129--

(a) It is customary to value inventories of fresh meats at the current market price irrespective of whether such price be more or less than cost. The reason for this exception to the conservative accounting rule of cost or market, whichever is the lower, is the fact that such goods must be sold within a very short period of time; that the amount realized therefor will be the current market price, and any fluctuation thereof will have a direct bearing on the realizable value of the inventory when sold in the regular course of trade. Moreover when the audit is being performed, the inventory on hand at the close of the fiscal period will in all probability have been disposed of, and the amount actually realized on the sale is the best evidence of the value of the inventory for balance sheet purposes.

In the case of hams, bacons, canned goods, etc., the rule of cost or market, whichever is the lower, is the most conservative price basis, although in actual practice the market price is generally used.

(b) The prices used by the management may be readily verified by comparison with the public quotation lists in the case of market price, and with the latest invoices in the case of cost price. The estimated selling expense deducted from the public quotation in arriving at market price may be tested by comparison with the actual selling expense of the preceding period.

Answer to Question 130--

BONDS may be classified according to:

1. The character of the issuing corporation
2. The purpose of the issue
3. Conditions of payment
4. The security of the bond

The explanations of the first three divisions of this classification are implied in the headings themselves, and they can be made as detailed as anyone desires, to meet his need. The variations included under (4), however, require an explanation of some of the more prominent types.

a) MORTGAGE BONDS are secured by a direct lien upon property. A simple corporate mortgage is in no important respect different from a mortgage of an individual except that the indenture is deposited with a trustee and the bonds which are outstanding are merely certificates or instruments representing a part share in the deposited mortgage. If the necessity for legal action arises, the trustee upon a stipulated vote stated in the mortgage acts as the agent for the bondholders.

There are several classes of mortgage bonds, e.g., first mortgage, which operates as a first lien on the property securing the bonds; second mortgage, which may be secured by the same property but is subject to the first lien. The important thing to note in the so-called mortgage bonds is that the lien is always upon a specified property; while the name of the most common issues will indicate what the lien is, it is not always a safe guide. In such a case it must be obtained from the mortgage instrument. The mortgage bond of a railroad, for example, may cover several different parts of the system and on each one of these parts the lien may differ.

b) COLLATERAL TRUST BONDS. Bonds secured by the deposit of collateral with a trustee under an agreement reciting the conditions of the trust are referred to as collateral trust bonds. The collateral usually takes the form of stock and bonds of either subsidiary companies owned by the company issuing the collateral trust bonds or the securities of other companies purchased as investments and used as collateral.

c) DEBENTURE BONDS. In finance, the debenture bond in this country (but not necessarily abroad) has come to be restricted to a bond which is not secured by a lien upon any specific property. It is a general claim upon all of the assets of the company, and all other mortgages with specific liens have priority to its claims. The debenture instrument issued today usually stipulates that the debenture will have precedent over any mortgage issued after its own date of issue. The most common types of debenture issues are debenture bonds, debenture income bonds, preference income bonds, plain bonds, all civil loans, and receiver's certificates.

d) INCOME BONDS. The payment of interest on income bonds is dependent upon the earnings of a company being sufficiently large to cover the amount of the interest. The effect, therefore, is that the interest on the bonds operates as a first lien on the net profits, and in the event there are no profits the interest on the bonds is not a liability of the company issuing the same. Interest on income bonds may, however, be either cumulative or non-cumulative. The distinction between preferred stock and income bonds is that in the latter case the principal is a direct obligation of the company and must be paid on maturity. The principal of income bonds may be secured or unsecured. An unsecured debenture is consequently commonly known as debenture income bond.

REFERENCES:
Montgomery, pages 190-234
Wildman, pages 155-158; 102-107

F. L. Barnes & Co.

28

Capital Stock

Capital Stock.

Jan. 1, 1915	Issued to F. L. Barnes and Sons for property transferred – 1500 shares		$ 150,000.00
Jan. 1, 1915	Sale (cash) at par, to M. J. Barnes		20,000.00
July 18, 1916	Sale (cash) to James B. Carey		18,100.00
Jan. 1, 1917	Sale (stock D. B. Story Co) Mrs. D. B. Story		30,000.00
May 12, 1917	Sale (cash + notes) to L. F. Dolson		11,900.00
Aug. 8, 1918	Sales (cash) to –		
	F. L. Barnes	$ 6,500.00	
	H. E. Barnes	7,500.00	
	M. J. Barnes	5,000.00	
	R. G. Somers	1,000.00	20,000.00
			$ 250,000.00

Certificates as follows –

			Amount	Total
June 15, 1916	F. L. Barnes	# 12	900 shares	1015 shares
"	H. E. Barnes	# 13	100 "	475 "
"	"	# 14	100 "	
"	"	# 15	100 "	
"	"	# 16	100 "	
"	M. J. Barnes	# 17	100 "	225 "
"	"	# 20	100 "	
July 18, 1916	Alan Johnson	# 21	100 "	100 "
"	F. L. Barnes	# 24	50 "	
"	James B. Carey	# 25	50 "	231 "
"	"	# 26	181 "	
Jan. 1, 1917	Mrs. D. B. Story	# 28	300 "	300 "
May 12, 1917	L. F. Dolson	# 29	119 "	119 "
Aug. 8, 1918	F. L. Barnes	# 31	65 "	
"	H. E. Barnes	# 32	75 "	
"	M. J. Barnes	# 33	25 "	
Aug. 8, 1918	R. G. Somers	# 35	10 "	10 "
Dec. 22, 1918	N. O. Borden	# 36	25 "	25 "
	Total shares outstanding		2,500 shares	2,500 shares

F. L. Barnes & Co.

Surplus account

		Dr.	Cr.
Dec. 31, 1915	Profits for year		$10,450.62
Dec. 31, 1916	" " "		14,607.18
Aug. 12, 1917	Dividend paid (2% on $230,000)	$4,600.00	
Dec. 31, 1917	Provision for S. F. Reserve	10,000.00	
Dec. 31, 1917	Profits for year		16,885.19
June 15, 1918	Underprovision for Federal Taxes	254.71	
Dec. 31, 1918	Provision for S. F. Reserve	10,000.00	
Dec. 31, 1918	Balance (without 1918 Profits)	17,088.28	
		$41,942.99	$41,942.99
Feb. 1, 1918	Dividend (5% of $230,000)	$11,500.00	

COMPLETE ACCOUNTING COURSE--PART II

Lecture 26

CONTINGENT AND MISCELLANEOUS LIABILITIES

Problem 57

You are required to point out (a) errors in principle and (b) misstatement of facts in the balance sheet and relative statement of profits and income of the American Optimist Co. shown below:

THE AMERICAN OPTIMIST COMPANY
BALANCE SHEET, DECEMBER 31, 1918

ASSETS

PROPERTY ACCOUNT AS AT JANUARY 1, 1917:			
Real Estate, Buildings, Plant, Machinery, Equipment, Patents, and Good-will, including Discount and Commission on Bonds Sold		$5,500,000.00	
ADD--Expenditures for Year in Dismantling Plant at Hoboken and in Remodeling and Reconstructing Department C, including all other Additions and Extensions		775,000.00	$ 6,275,000.00
CURRENT ASSETS:			
Stocks and Bonds in Treasury at par........		$2,000,000.00	
Investments in other Companies held as Permanent Investments		375,000.00	
Inventories on Hand:			
Raw Materials and Supplies (at cost)	$2,600,000.00		
Finished Goods and Work in Progress	500,000.00		
Consigned Merchandise (Selling Values)	150,000.00	3,250,000.00	
Contracts under Way:			
Amount of Contracts	$2,500,000.00		
LESS--Estimated Cost to complete	1,000,000.00	1,500,000.00	
Accounts and Bills Receivable (Gross)		1,400,000.00	
Cash and other Cash Assets, including Deposits with Trustee under Mortgage		650,000.00	9,175,000.00
DEFERRED CHARGES TO FUTURE OPERATIONS:			
Prepaid Interest, Insurance, etc., and Advertising Expenses carried forward			325,000.00
			$15,775,000.00

LIABILITIES

CAPITAL STOCK:			
50,000 Shares of $100 each			$ 5,000,000.00
BONDED INDEBTEDNESS OUTSTANDING OR REDEEMED AND HELD BY TRUSTEE (20-year Bonds)			3,000,000.00
CURRENT LIABILITIES:			
Bills Payable		$3,500,000.00	
Accounts Payable and Audited Vouchers, including Pay-Rolls and Interest due but unpaid		750,000.00	
Taxes Accrued		25,000.00	4,275,000.00
RESERVE FUNDS:			
For Depreciation and Accruing Renewals (Less Expenditures)		$ 50,000.00	
Bond Sinking Fund		400,000.00	
For Unaudited Bills on Hand		50,000.00	500,000.00
SURPLUS:			
Balance at January 1, 1918		$2,500,000.00	
LESS--Adjustments		250,000.00	
		$2,250,000.00	
Net Earnings for Year as per Statement attached		1,500,000.00	
		$3,750,000.00	
LESS--Appropriations:			
For Dividends	$500,000.00		
Bond Sinking Fund	100,000.00		
Depreciation	150,000.00	750,000.00	3,000,000.00
			$15,775,000.00

THE AMERICAN OPTIMIST COMPANY
STATEMENT OF PROFITS AND INCOME, YEAR ENDING DECEMBER 31, 1918

GROSS SALES AND CONSIGNMENTS (excluding Contracts)		$8,575,000.00
Deduct--Cost of Sales		6,825,000.00
BALANCE--GROSS PROFITS ON GENERAL BUSINESS		$1,750,000.00
ADD--Profits on Contracts in Progress		275,000.00
MISCELLANEOUS INCOME:		
Profits on Bonds Purchased	$ 15,000.00	
Interest received on Sundry Investments	25,000.00	
Sundry Items	35,000.00	75,000.00
TOTAL PROFITS AND INCOME FROM ALL SOURCES		$2,100,000.00
DEDUCT--Administration and Selling Expenses	$325,000.00	
Taxes	25,000.00	
Interest Charges	250,000.00	600,000.00
BALANCE--NET EARNINGS FOR THE YEAR		$1,500,000.00

Problem 58

James Hewson and Walter Fellows had been in partnership for several years, and at December 31, 1919, desiring to retire, they entered into an arrangement to dispose of their business to William Jones, on the general terms that he, Jones, should take over everything as it then stood, subject to the following conditions:

1. Inventory of merchandise to be subject to a rebate of 6%.
2. Accounts receivable to have a deduction of 7½% to meet possible losses.
3. Office furniture to be subject to a deduction of 12½% for depreciation.
4. Liabilities to creditors to be discharged by February 1.

On the exact amount required to be paid over to the parties by Jones being ascertained, he was to pay one-fourth in cash on February 4, and the balance by equal instalments, giving his notes for the same which are paid in cash as they fall due, dating from January 1, at three, six, and nine months, such instalments to carry interest at 5% per annum.

The inventory of merchandise in hand amounted to $21,800, the accounts receivable to $18,200, and the office furniture stood in the books at $1,250. The sums due to creditors amounted to $6,250.

You are asked, as representing Jones, to prepare the ledger accounts as they should be recorded and give effect to the foregoing arrangement in Jones's ledger.

QUESTIONS ON AUDITING

Question 141--During the audit you are making of the accounts of a corporation, you become aware of a claim against the company which you think is likely to be enforced, but which the directors do not recognize, and for which they will make no reserve. What would you do in the circumstances?

Question 142--

(a) Define the relation between the directors of a company and the company.

(b) In the course of your audit of a company you ascertain the following facts:

(1) One of the directors has sold a considerable quantity of goods of the company.
(2) The directors have passed a resolution for payment to themselves of traveling expenses incurred in attending board meetings.
(3) They have also passed a resolution waiving half their directors' fees for the current year.

Do these points concern you as auditor, and if so, how would you deal with them?

Question 143--What authority would you require as auditor for passing the remuneration of the directors of a company, and to what book would you refer to ascertain the names of the persons entitled thereto?

Question 144--What measures should be taken to ascertain whether or not any notes receivable have been discounted and cleared from the books, notwithstanding the fact that they are not due and at maturity will be subject to demand on the last indorser in case payment is defaulted by the maker?

Question 145--As an auditor what sort of documentary evidence would you require in support of the following expenditures:

(a) Shop wages paid
(b) Dividends paid
(c) Merchandise purchases

Solution to Problem 52

The feature in this problem appears to be, that B in submitting a statement to A did not prepare a statement of profit and loss, but dealt only with the receipts from sales and disbursements for purchases and expenses represented in the advance.

The following is the correct statement of the profits:

PARTICULARS		AMOUNT
SALES		$350,000.00
DEDUCT--Cost of Sales and Expenses:		
Inventory January 1	$ 45,000.00	
Purchases and Expenses	284,000.00	
	$329,000.00	
LESS--Inventory December 31	48,500.00	280,500.00
		$ 69,500.00
BALANCE--PROFIT		

A's account on B's books would appear thus:

DEBITS		CREDITS		
Sale of Plant	$400,000.00	Cash Received on Account		$100,000.00
Interest on Deferred Payments	18,000.00	Profit for Year		69,500.00
Interest on Advances	7,670.00	Balance due January 1:		
		1919	$106,170.00	
		1920	150,000.00	256,170.00
	$425,670.00			$425,670.00

B's account on A's books would appear thus:

DEBITS			CREDITS	
Cash Paid on Account		$100,000.00	Sale of Plant	$400,000.00
Assets taken over Dec. 31:			Interest on Deferred Instalments	18,000.00
Cash	$ 88,500.00		Interest on Advances	7,670.00
Inventory	48,500.00		Inventory January 1, 1918	45,000.00
Accts. Rec.	6,000.00	143,000.00	Accounts Receivable January 1, 1918	28,500.00
Balance due January 1:				
1919	$106,170.00			
1920	150,000.00	256,170.00		
		$499,170.00		$499,170.00

Solution to Problem 53

SKELETON JOURNAL ENTRIES

	(1)		
Organization Expenses		$ 5,000.00	
To--Capital Stock			$ 5,000.00
	(2)		
Plotted Tracts		50,000.00	
To--Mortgage Payable			34,000.00
Accounts Payable			16,000.00
	(3)		
Plotted Tracts		7,000.00	
To--Accounts Payable			7,000.00
	(4)		
Dwelling House Account		1,200.00	
To--Plotted Tracts			1,200.00
	(5)		
Dwelling House		13,000.00	
To--Accounts Payable			13,000.00
	(6)		
Accounts Receivable		9,000.00	
To--Dwelling House Sales			9,000.00
	(7)		
Accounts Receivable		30,200.00	
To--Plotted Tracts Sales			30,200.00
	(8)		
Accounts Payable		4,000.00	
To--Notes Payable			4,000.00
	(9)		
Plotted Tract Sales		19,800.00	
To--Plotted Tracts			19,800.00
	(10)		
Dwelling House Sales		7,100.00	
To--Dwelling House			7,100.00
	(11)		
Dwelling House Sales		1,900.00	
Plotted Tract Sales		10,400.00	
Commission and Fees		905.00	
To--Profit and Loss			13,205.00

(12)

Profit and Loss		$ 9,219.00	
To--Interest			$ 1,719.00
Expenses			7,500.00

(13)

Profit and Loss		3,986.00	
To--Surplus			3,986.00

CASH BOOK

RECEIPTS		PAYMENTS	
Capital Stock	$25,000.00	Organization Expenses	$ 625.00
Accounts Receivable	20,075.00	Accounts Payable	16,000.00
Interest	750.00	Plotted Tracts	6,000.00
Loan	12,000.00	Accounts Payable	1,000.00
Commission & Fees	905.00	Accounts Payable	7,000.00
		Mortgage Payable	11,300.00
		Bills Payable	3,000.00
		Interest	1,719.00
		Expenses	7,500.00
		Balance	4,586.00
	$58,730.00		$58,730.00

LEDGER ACCOUNTS

CAPITAL STOCK

Balance	$30,000.00	Cash	$25,000.00
		Organization Expenses	5,000.00
	$30,000.00		$30,000.00

PLOTTED TRACTS

Accounts & Mtgs. Payable	$50,000.00	Dwelling House	$ 1,200.00
Cash	6,000.00	Plotted Tract Sales	19,800.00
Accounts Payable	7,000.00	Balance	42,000.00
	$63,000.00		$63,000.00

DWELLING HOUSE

Plotted Tracts	$ 1,200.00	Dwelling House Sales	$ 7,100.00
Accounts Payable	13,000.00	Balance	7,100.00
	$14,200.00		$14,200.00

ACCOUNTS RECEIVABLE

Dwelling House Sales	$ 9,000.00	Cash	$20,075.00
Plotted Tracts Sales	30,200.00	Balance	19,125.00
	$39,200.00		$39,200.00

CASH

Receipts	$58,730.00	Disbursements	$54,144.00
		Balance	4,586.00
	$58,730.00		$58,730.00

ACCOUNTS PAYABLE

Cash	$16,000.00	Plotted Tracts	$16,000.00
Cash	7,000.00	Plotted Tracts	7,000.00
Cash	1,000.00	Dwelling House Account	13,000.00
Notes Payable	4,000.00		
Balance	8,000.00		
	$36,000.00		$36,000.00

MORTGAGES PAYABLE

Cash	$11,300.00	Plotted Tracts	$34,000.00
Balance	22,700.00		
	$34,000.00		$34,000.00

LOAN ACCOUNT

Balance	$12,000.00	Cash	$12,000.00

BILLS PAYABLE

Cash	$3,000.00	Accounts Payable	$4,000.00
Balance	1,000.00		
	$4,000.00		$4,000.00

ORGANIZATION EXPENSES

Capital Stock	$5,000.00	Balance	$5,625.00
Cash	625.00		
	$5,625.00		$5,625.00

PLOTTED TRACT SALES

Plotted Tract	$19,800.00	Accounts Receivable	$30,200.00
Profit and Loss	10,400.00		
	$30,200.00		$30,200.00

DWELLING HOUSE SALES

Dwelling House	$7,100.00	Accounts Receivable	$9,000.00
Profit and Loss	1,900.00		
	$9,000.00		$9,000.00

COMMISSIONS & FEES

Profit and Loss	$905.00	Cash	$905.00

INTEREST RECEIVED

Profit and Loss	$750.00	Cash	$750.00

EXPENSES

Cash	$7,500.00	Profit and Loss	$7,500.00

INTEREST PAID

Cash	$1,719.00	Profit and Loss	$1,719.00

PROFIT AND LOSS

Expenses	$ 7,500.00	Dwelling House Sales	$ 1,900.00
Interest	1,719.00	Plotted Tract Sales	10,400.00
Surplus	4,736.00	Commissions and Fees	905.00
		Interest Received	750.00
	$13,955.00		$13,955.00

SURPLUS

		Profit and Loss	$4,736.00

Exhibit A

LAND DEVELOPMENT COMPANY
BALANCE SHEET, (Date)

ASSETS			LIABILITIES		
TRACTS AND HOUSES HELD FOR SALE:			CAPITAL STOCK		$30,000
Plotted Tracts (at cost)	$42,000		MORTGAGE PAYABLE		22,700
Dwelling House (at cost)	7,100	$49,100	CURRENT LIABILITIES:		
			Bills Payable	$ 1,000	
			Loans	12,000	
CURRENT ASSETS:			Accts. Payable	8,000	21,000
Accounts Receivable	$19,125				
Cash	4,586	23,711	SURPLUS:		
DEFERRED CHARGES:			Surplus Net Profits for period ending..........		
Organization Expenses		5,625	(Exhibit B)		4,736
		$78,436			$78,436

Inasmuch as the tracts are being disposed of it would be desirable to charge off part of the organization expenses, say about one-third.

Exhibit B

LAND DEVELOPMENT COMPANY
STATEMENT OF PROFITS AND INCOME
FOR.......MONTHS ENDING...........

	PLOTTED TRACTS	DWELLING HOUSES	TOTAL
SALES	$30,200.00	$9,000.00	$39,200.00
DEDUCT--Cost of Sales	19,800.00	7,100.00	26,900.00
GROSS PROFIT	$10,400.00	$1,900.00	$12,300.00
ADD--MISCELLANEOUS INCOME:			
Commissions and Fees		$905.00	
Interest Received		750.00	1,655.00
			$13,955.00
DEDUCT--Expenses			7,500.00
NET PROFIT FROM OPERATIONS			$ 6,455.00
DEDUCT--Interest Paid			1,719.00
SURPLUS NET PROFITS			$ 4,736.00

ANSWERS TO QUESTIONS

Answer to Question 131--

(a) First mortgage 5% bonds:

1. Obtain a certificate from the trustees under the indenture as to the amount of bonds outstanding at the date of the balance sheet as shown by the trustee's records. Reconcile certificate with general ledger account.

2. Examine trust deed to ascertain provisions bearing on the amount of bonds which may be outstanding at the balance sheet date.

(b) Preferred stock:

1. In case this stock is taken care of by a registrar obtain a certificate from the registrar as to the amount of stock outstanding at the date of the balance sheet as shown by the registrar's records. Compare this certificate with the general ledger account.

2. In case this stock is taken care of by the secretary of the company, list the certificates outstanding as shown by the stock certificate book, thus:

NUMBER OF CERTIFICATE	TO WHOM ISSUED	NO. OF SHARES	AMOUNT

Note whether the total agrees with the balance in the general ledger account.

3. Note whether any blank certificates are missing.

4. See that all canceled certificates are pasted to the corresponding stubs.

5. If the procedure outlined in (2) is not deemed to be a sufficient verification, take off a trial balance of the stock ledger. The total shown by the trial balance should agree with the total of the schedule of stock certificates, and with the balance shown by the Preferred Stock account in the general ledger.

Answer to Question 132--The effect of this treatment in the accounts is to understate the asset of materials and supplies and per contra the liability of audited vouchers payable. At the close of the fiscal period an entry should be introduced charging Materials and Supplies and crediting Unaudited Invoices. Inasmuch as the liability exists at the balance sheet date it must be reflected on the balance sheet before the true financial condition can be stated. In case the amount involved is insignificant, the auditor may ignore same if in his opinion it would not affect the financial condition of the company.

Answer to Question 133--The records of the transactions would be as follows:

JOURNAL

(1)

Unissued First Mortgage 4% Bonds	$50,000.00	
To--First Mortgage 4% Bonds		$50,000.00
To record the authorized issue of 100 first mortgage 4% bonds as per resolution adopted by stockholders at a meeting held on.............		

(2)

Discount on Bonds	2,000.00	
To--Unissued First Mortgage 4% Bonds		2,000.00
To record discount allowed on sale of 100 bonds of $500 each.		

CASH BOOK ENTRY

Cash	$48,000.00	
To--Unissued First Mortgage 4% Bonds		$48,000.00
To record proceeds from sale of 100 first mortgage 4% bonds, par value $500 each.		

Answer to Question 134--

(a) DISCOUNT ON BONDS OR STOCK

(1) Bond discount. It is now generally recognized that discount on bonds is an addition to the nominal rate of interest paid and as such should be spread over the term of the bonds. The proportion pertaining to the period of construction is admitted as a proper charge against the cost of construction of a plant.

The amount of the discount would be charged to a Discount on Bonds account, which should be relieved from time to time with the credits in respect of the proportion chargeable to either (a) Profit and Loss account or (b) Construction account, as the case may be.

(2) Discount on Stock. The question arises first of all as to whether or not stock (at least in most states) can be sold at a discount. In the event it is done, the amount of discount should be charged to a Discount on Stock account and so shown on the face of the balance sheet.

(b) PREMIUM ON STOCK OR BONDS

(1) Premiums on bonds. Premiums on bonds are the reverse of discounts on bonds. The premium when received should be credited to a Bond Premiums account to be spread over the term of the bonds and applied in reduction of the nominal rate of interest paid. Periodically bond premiums should be charged with the proportion of the premium applicable to that period, the contra credit being made to: (a) Profit and Loss account or (b) Property or Construction account, as the case may be.

(2) Premiums on stock. The amount received over and above the par value of the shares should be credited to Premium on Stock account or Capital Surplus account. The latter term is used to differentiate same from surplus arising from the regular operations of the concern.

(c) BONUS COMMON STOCK. In this case the common stock was issued as a bonus with the sale of preferred stock. It should be charged to Common Stock Bonus account, being in effect a discount on the preferred stock. Frequently, however, bonuses are regarded as organization expenses and so dealt with.

To audit the discount or premiums on bonds, obtain the periodical reports of the bankers handling the bond issue. These reports indicate the amount of bonds sold, when sold, and the discount or premium arising from the sale. Verify the amount of discount or premium unamortized and note whether the amortized discount or premium has been properly dealt with as between:

1. Current Profit and Loss account
2. Surplus
3. Property or Construction

It would be advisable to examine the minute book for resolutions bearing on the terms on which bonds should be sold. There will probably be a contract between the bankers and the company outlining the terms of the sale.

In the audit of discount on stock, premium on stock, and bonus common stock, examine the minute book for resolutions bearing on the terms upon which each class of stock should be sold. Check the various stock transactions to ascertain whether the proper premium was received, and whether the allowances for stock discount and the amount of bonus common stock are correct.

<u>Answer to Question 135</u>--Receipts for payments on account of subscription should be written up in duplicate and the receipt book numbered consecutively in advance. When receipts are issued the original is given to the subscriber and the duplicate surrendered to the office. Broadly speaking, the scheme of bookkeeping would be as follows:

1. General ledger, in which all asset, liability, income, and expense accounts would be kept.
2. General cash book, arranged in columnar form in order to facilitate posting.
3. Record of audited vouchers.
4. General journal.

All checks should be signed and countersigned; all receipts deposited intact, and a petty cash fund established. In addition, regular financial statements should be prepared, setting forth the results from operation and the financial position of the institution.

To guard as far as possible against the collection and withholding of funds by the collector through the use of a receipt other than the official form, it is advisable to publish in the annual report a list of subscribers and donors showing the amount of each subscription and donation. This annual report should be mailed to every contributor. But oftentimes it will be found that some contributors will object to publication of their names and contributions.

Consequently it is difficult to ascertain whether an item has been properly or improperly omitted, because the amounts involved are usually the same.

REFERENCES:
Montgomery, pages 168-181; 185-190
Wildman, pages 61-65; 48-58

F. L. Barnes & Co.

Analysis of Sales

Style	Year	Jan.		Feb.		March		April		May		June	
180	1917	1	$60.00	2	$120.00	2	$120.00	4	$240.00	–	$– –	1	$65.00
	1918	–	– –	1	55.00	–	– –	2	110.00	1	60.00	1	60.00
181	1917	83	6,475.80	72	5,616.00	75	5,900.00	60	4,680.00	65	5,070.00	65	5,085.00
	1918	84	6,587.50	80	6,240.00	115	8,970.00	95	7,427.31	101	7,878.00	103	8,036.50
183	1917	73	7,008.00	70	6,720.00	60	5,772.81	68	6,527.50	72	6,912.00	70	6,725.43
	1918	72	6,912.00	75	7,212.50	71	6,817.23	76	7,309.10	78	7,300.65	79	7,584.00
185	1917	92	10,120.00	104	11,448.96	90	9,900.00	84	9,240.00	100	11,010.41	102	11,220.00
	1918	101	11,110.00	102	11,220.00	106	11,664.20	104	11,440.00	110	11,110.00	132	14,535.16
187	1917	31	3,720.00	40	4,880.00	52	6,240.00	41	4,920.00	36	4,320.00	40	4,880.00
	1918	41	4,920.00	40	4,881.10	50	6,000.00	62	7,440.00	60	7,200.00	58	6,960.00
Specials	1917	3	301.40	6	582.20	10	794.12	4	372.18	1	84.21	–	– –
	1918	2	164.20	3	298.16	8	723.21	8	701.40	5	491.32	3	314.09
Misc.	1917	–	– –	–	– –		422.00		16.71	–	– –		812.10
	1918		– –		– –		– –		– –		312.50		– –
1917			$27,685.20		$29,367.16		$29,148.93		$25,996.39		$27,396.62		$28,787.53
1918			$29,693.70		$29,906.76		$34,174.64		$34,427.81		$34,352.47		$37,489.75

Style	Year	July		Aug.		Sept.		Oct.		Nov.		Dec.	
180	1917	2	$115.00	1	$60.00	1	$85.00	3	$180.00	–	$– –	–	$– –
	1918	1	55.00	–	– –	–	– –	–	– –	–	– –	1	50.00
181	1917	54	4,212.00	60	4,695.00	62	4,852.00	52	4,093.27	56	4,371.00	74	5,772.00
	1918	100	7,820.00	92	7,191.00	95	7,512.00	95	7,410.00	114	8,800.00	102	7,956.00
183	1917	68	6,528.00	74	7,104.00	71	6,816.00	53	5,091.50	61	5,856.20	60	5,760.00
	1918	81	7,776.00	74	7,104.00	73	7,008.00	64	6,144.50	68	6,525.00	70	6,720.00
185	1917	101	11,111.12	97	10,670.00	90	9,901.00	83	9,130.00	96	10,560.00	100	11,000.00
	1918	108	11,880.00	115	12,650.00	101	11,110.00	100	11,003.80	105	11,550.00	118	12,980.00
187	1917	37	4,440.00	38	4,560.00	36	4,320.00	20	2,412.81	41	4,920.00	35	4,200.00
	1918	71	8,520.00	43	5,160.00	48	5,760.00	49	5,881.15	52	6,240.00	50	6,000.00
Specials	1917	2	181.00	4	357.26	3	296.33	8	804.01	–	– –	1	83.20
	1918		– –	–	– –	8	724.18	14	1,401.08	–	– –	–	– –
Misc.	1917		1,761.80	–	– –		42.01		– –		– –		78.14
	1918		350.00		81.12		– –		345.08		– –		– –
1917			$28,348.92		$27,460.26		$26,312.34		$21,711.59		$25,707.20		$26,893.34
1918			$36,401.00		$32,186.12		$32,114.18		$32,185.61		$33,115.00		$33,706.00

	Totals 1917		Totals 1918		Increase or Decrease *	
180	17	$1,045.00	7	$390.00	10*	$655.00*
181	778	60,822.07	1176	91,828.31	398	31,006.24
183	800	76,821.44	881	84,412.98	81	7,591.54
185	1139	125,311.49	1302	142,253.16	163	16,941.67
187	447	53,817.81	624	74,967.25	177	21,149.44
Specials	42	3,849.91	51	4,817.64	9	967.73
Miscellaneous		3,132.76		1,088.70		2,044.06*
Total		$324,795.48		$399,753.04		$74,957.56

F. L. Barnes & Co.

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Analysis of Discounts on Sales to Improved K. C. Co.

Style	Year	Jan.		Feb.		March		April		May		June	
			$		$		$		$		$		$
180	1917	—	—	1	12.00	1	12.00	3	36.00	—	—	—	—
	1918	—	—	—	—	—	—	1	12.00	—	—	1	12.00
181	1917	80	1,248.00	70	1,092.00	72	1,123.20	58	904.80	64	998.40	62	967.20
	1918	81	1,263.60	68	1,060.80	110	1,716.00	90	1,404.00	99	1,544.40	100	1,560.00
183	1917	69	1,324.80	67	1,286.40	58	1,113.60	64	1,228.80	70	1,344.00	67	1,286.40
	1918	70	1,344.00	70	1,344.00	70	1,344.00	75	1,440.00	74	1,420.80	76	1,459.20
185	1917	88	1,953.60	100	2,220.00	88	1,953.60	80	1,776.00	95	2,109.00	99	2,197.80
	1918	98	2,175.60	97	2,153.40	102	2,264.40	101	2,242.20	108	2,397.60	129	2,863.80
187	1917	30	720.00	38	912.00	49	1,176.00	40	960.00	34	816.00	37	888.00
	1918	38	912.00	39	936.00	46	1,104.00	55	1,320.00	59	1,416.00	56	1,344.00
Specials	1917	2	40.18	4	77.60	9	142.94	2	37.22	1	16.84	—	—
	1918	1	16.40	—	—	5	90.40	6	105.12	3	58.96	1	20.94
1917			$ 5,286.58		$ 5,600.00		$ 5,521.34		$ 4,942.82		$ 5,284.24		$ 5,339.40
1918			$ 5,711.00		$ 5,494.20		$ 6,518.80		$ 6,523.32		$ 6,837.76		$ 7,259.90

Style	Year	July		Aug.		Sept.		Oct.		Nov.		Dec.	
			$		$		$		$		$		$
180	1917	2	24.00	—	—	—	—	2	24.00	—	—	—	—
	1918	—	—	—	—	—	—	—	—	—	—	—	—
181	1917	50	780.00	56	873.60	59	920.40	48	748.80	54	842.40	70	1,092.00
	1918	97	1,513.20	90	1,404.00	91	1,419.60	90	1,404.00	111	1,731.60	98	1,528.80
183	1917	65	1,248.00	71	1,363.20	67	1,286.40	50	960.00	58	1,113.60	55	1,056.00
	1918	79	1,516.80	70	1,344.00	69	1,324.80	59	1,132.80	66	1,267.20	68	1,305.60
185	1917	99	2,197.80	94	2,086.80	86	1,909.20	80	1,776.00	92	2,042.40	97	2,153.40
	1918	105	2,331.00	113	2,508.60	90	1,998.00	94	2,086.80	104	2,308.80	114	2,530.80
187	1917	33	792.00	31	744.00	32	768.00	19	456.00	37	888.00	30	720.00
	1918	70	1,680.00	41	984.00	44	1,056.00	45	1,080.00	50	1,200.00	45	1,080.00
Specials	1917	—	—	2	35.12	1	19.75	6	120.60	—	—	1	16.64
	1918	—	—	—	—	3	54.30	11	220.11	—	—	—	—
1917			$ 5,041.80		$ 5,102.72		$ 4,903.75		$ 4,085.40		$ 4,886.40		$ 5,038.04
1918			$ 7,041.00		$ 6,240.60		$ 5,852.74		$ 5,923.71		$ 6,507.60		$ 6,445.20

	Totals 1917		Totals 1918		Additional Allowances 1917		Additional Allowances 1918	
180	9	$ 108.00	2	$ 24.00		$		$
181	743	11,590.80	1125	17,550.00	2%	1,159.08	2%	1,755.00
183	761	14,611.20	846	16,243.20	"	1,461.12	"	1,624.32
185	1098	24,375.60	1255	27,861.00	"	2,437.56	"	2,786.10
187	410	9,840.00	588	14,112.00	"	984.00	"	1,411.20
Specials	28	506.89	30	566.23	—	—	—	—
	3049	$ 61,032.49	3846	$ 76,356.43		$ 6,041.76		$ 7,576.62

COMPLETE ACCOUNTING COURSE--PART II

Lecture 27

CONSOLIDATED BALANCE SHEET

Problem 59

The Central Manufacturing Co. has owned the controlling interest in John Doe & Co. and Richard Roe & Co. since the subsidiaries were organized. From the balance sheets of the respective companies given below prepare a consolidated balance sheet. Attach thereto your working papers showing how the consolidated balance sheet figures were arrived at.

JOHN DOE & CO.
BALANCE SHEET, APRIL 1, 1919

ASSETS			LIABILITIES		
CAPITAL ASSETS:			CAPITAL STOCK:		
Plant and Equipment		$ 50,000	750 shares at $100		$ 75,000
CURRENT ASSETS:			CURRENT LIABILITIES:		
Inventories	$30,000		Accounts Payable	$27,000	
Advance to Richard			Notes Payable--		
Roe & Co.	3,500		Central Mfg. Co.	8,500	
Customers	25,000		Dividends Payable	3,000	38,500
Cash	5,000	63,500			
		$113,500			$113,500

RICHARD ROE & CO.
BALANCE SHEET, APRIL 1, 1919

ASSETS			LIABILITIES		
CAPITAL ASSETS:			CAPITAL STOCK:		
Plant & Equipment		$ 97,500	1,250 shares at $100		$125,000
CURRENT ASSETS:			CURRENT LIABILITIES:		
Inventories	$47,400		Accounts Payable	$46,500	
Customers	25,000		Advances from		
Advances to Central			John Doe & Co.	3,500	50,000
Mfg. Co.	7,500				
Cash	3,850	83,750	SURPLUS		6,250
		$181,250			$181,250

CENTRAL MANUFACTURING COMPANY
BALANCE SHEET, APRIL 1, 1919

ASSETS

CAPITAL ASSETS:		
Investment in the Capital Stock of John Doe & Co., 750 shares at $100	$100,000	
Investment in the Capital Stock of Richard Roe & Co., 1,000 shares at $100	90,000	$190,000
CURRENT ASSETS:		
Notes Receivable of Richard Roe & Co.	$ 8,500	
Dividends Receivable	3,000	
Cash	59,000	70,500
		$260,500

LIABILITIES

CAPITAL STOCK:	
2,500 shares at $100	$250,000
CURRENT LIABILITIES:	
Advances from Richard Roe & Co.	7,500
SURPLUS	3,000
	$260,500

Problem 60

From the following comparative balance sheets at December 31, 1918, and June 30, 1919, prepare statement showing the change in the financial condition of the C D Company between those dates:

ASSETS

	DEC. 31, 1918	JUNE 30, 1919
Plant and Equipment	$310,000.00	$375,000.00
LESS--Reserve for Depreciation	90,000.00	100,000.00
	$220,000.00	$275,000.00
Investment in:		
X Y Z Company	$ 62,000.00	-----------
P Q Company	120,000.00	$148,000.00
	$182,000.00	$148,000.00
Current Assets:		
Inventories	$138,000.00	$ 96,200.00
Customers' Accounts less Reserve for Bad Debts and Discounts	31,200.00	89,700.00
Officers and Employees	6,200.00	4,050.00
Cash	7,400.00	14,500.00
	$182,800.00	$204,450.00
Deferred Charges (2)	$ 4,800.00	$ 8,550.00
	$589,600.00	$636,000.00

LIABILITIES

	DEC. 31, 1918	JUNE 30, 1919
Capital Stock	$ 50,000.00	$ 50,000.00
First Mortgage 6% Gold Bonds due 1929 (1)	-----------	$100,000.00
Purchase Money Obligation	$ 12,500.00	$ 12,500.00
Current Liabilities:		
Notes Payable	$146,000.00	$ 19,400.00
Audited Vouchers	39,000.00	53,000.00
Other Accounts Payable	3,300.00	3,800.00
	$188,300.00	$ 76,200.00
Surplus	$338,800.00	$397,300.00
	$589,600.00	$636,000.00

NOTES--

(1) The 6% bonds were sold for cash at 91.

(2) Bond discount $9,000, less $450 charged off during six months ending June 30, 1919.

Problem 61

On January 1, 1919, X Y Z Co. acquired the entire capital stock of the P Q Co., consisting of 1,000 shares of a par value of $100 each, for which was paid the sum of $150,000. After the transaction was recorded on the books of the X Y Z Co. the balance sheets of the two companies were as follows:

ASSETS	X Y Z COMPANY		P Q COMPANY	
Real Estate	$ 50,000.00		$ 25,000.00	
Building, Plant, & Equipment	75,000.00		45,000.00	
Good-Will	25,000.00			
Investment in P Q Company	150,000.00			
Inventories	80,000.00		20,000.00	
Accounts Receivable	*60,000.00		70,000.00	
Cash	10,000.00		15,000.00	
LIABILITIES				
Accounts Payable		$ 50,000.00		*$50,000.00
Loans		50,000.00		
Capital Stock		250,000.00		100,000.00
Surplus		100,000.00		25,000.00
	$450,000.00	$450,000.00	$175,000.00	$175,000.00

*Includes account of $15,000 due by P Q Co. to X Y Z Co.

Prepare a consolidated balance sheet attaching thereto the working sheets used.

QUESTIONS ON AUDITING

Question 146-147--How would you vouch the following items appearing in the books of a company you are auditing; and state specifically the papers or documents you would call for in support of the disbursement:

(a) The Rapid Typewriter Co.	
Typewriter purchased in exchange for old one	$ 30.00
(b) Alex. Greene	
Real Estate for plant site	7,500.00
(c) Automatic Sprinkler Co.	
Instalment paid on sprinkler system	1,000.00
(d) John Mace	
Stumpage purchased for	625.00
(e) Safety Trust Co.	
Par value $3,000 bonds	2,970.00
(f) Machinery constructed and erected by the company's staff	10,500.00
(g) John Jones, Salesman	
Traveling expenses for week	73.20
(h) A B Company	
Note payable discounted	987.50

Question 148--How would you guard against using a voucher twice for the payment of money?

Question 149--In the verification of cash disbursements what sort of evidence would you require? Moreover, would you regard it sufficient to accept the regular bank statement or passbook in support of the balance in bank at the date of the verification?

Question 150--What courses should an auditor pursue in order to verify the correctness of the following items:

(a) Allowances made to customers
(b) Calls in arrear

Solution to Problem 54

Exhibit A

EDWARDS MANUFACTURING COMPANY
BALANCE SHEET, DECEMBER 31, 1918

ASSETS

			Cost Value	Reserve for Depreciation	Book Value
CAPITAL ASSETS:					
Real Estate			$ 23,500.00	$---------	$ 23,500.00
Buildings			133,127.11	3,328.18	129,798.93
Machinery and Equipment			64,133.34	6,413.33	57,720.01
Tools and Running Gear			13,113.78	1,311.38	11,802.40
			$233,874.23	$11,052.89	$222,821.34
CURRENT ASSETS:					
Inventories:					
Raw Materials	$24,308.14				
In Process	33,987.32				
Finished Product	40,398.50	$98,693.96			
Customers' Accounts		93,183.27			
Notes Receivable		19,422.03			
Sundry Debtors		1,378.34			
Cash:					
With Fiscal Agents	$3,425.00				
Banks	6,908.73	10,333.73			$223,011.33
DEFERRED CHARGES:					
Insurance Unexpired					450.00
					$446,282.67

LIABILITIES

CAPITAL STOCK:			
Preferred Stock		$100,000.00	
Common Stock		125,000.00	$225,000.00
FIRST MORTGAGE 6% BONDS			100,000.00
CURRENT LIABILITIES:			
Notes Payable		$ 45,670.00	
Trade Creditors		33,198.34	
Matured Interest Coupons		3,425.00	
Accrued Interest on Bonds and Notes		1,125.00	
Accrued Taxes		2,234.83	
Accrued Wages		13,134.87	98,788.04
SURPLUS ACCOUNT:			
Balance at January 1, 1918		$ 42,493.98	
LESS--Net Loss year ended Dec. 31, 1918 (Exhibit B)		19,999.35	22,494.63
			$446,282.67

Exhibit B

EDWARDS MANUFACTURING COMPANY
STATEMENTS OF PROFITS AND INCOME
YEAR ENDING DECEMBER 31, 1918

GROSS SALES			$583,111.37
Deduct--Discounts on Sales		$18,343.11	
Freight Outward		12,397.50	
Allowances		11,832.50	42,573.11
NET PROCEEDS FROM SALES			$540,538.26
Cost of Goods Sold (Exhibit C)			523,353.90
GROSS PROFITS FROM OPERATION			$ 17,184.36
ADD--Other Income--Discount on Purchases			3,118.93
TOTAL PROFITS AND INCOME FROM ALL SOURCES			$ 20,303.29
DEDUCT--SELLING AND GENERAL EXPENSES:			
Selling Expenses:			
Salesmen's Salaries and Commissions	$10,375.50		
Insurance	1,000.00		
Bad Debts	937.11		
Traveling Expenses	3,983.21	$16,295.82	
General Expenses:			
Officers' Salaries	$11,500.00		
Traveling Expenses	1,983.50	13,483.50	29,779.32
NET LOSS FROM OPERATIONS			$ 9,476.03
ADD--Interest on Bonds and Bills Payable			10,523.32
TOTAL LOSS--Carried to Surplus Account (Exhibit A)			$ 19,999.35

Exhibit C

EDWARDS MANUFACTURING COMPANY
STATEMENT OF COST OF PRODUCTION AND GOODS SOLD
FOR YEAR ENDING DECEMBER 31, 1918

MATERIALS USED:			
Inventory of Raw Materials at January 1, 1918		$ 23,083.27	
Purchases		284,311.93	
Freight Inward		19,067.27	
		$326,462.47	
Less--Inventory of Raw Materials at Dec. 31, 1918		24,308.14	$302,154.33
WAGES			162,462.18
INDIRECT FACTORY EXPENSES:			
Superintendent's Salary		$ 2,400.00	
Taxes		2,234.83	
Insurance		1,000.00	
Light, Heat, and Power		2,483.11	
Royalties		3,307.50	
Repairs and Maintenance		19,083.27	
Depreciation on:			
Buildings	$3,328.18		
Machinery and Equipment	6,413.33		
Tools and Running Gear	1,311.38	11,052.89	
Miscellaneous Factory Expenses		3,350.31	44,911.91
			$509,528.42
DEDUCT--INCREASE IN INVENTORY OF WORK IN PROCESS:			
Inventory at January 1, 1918		$ 10,100.00	
Inventory at December 31, 1918		33,987.32	23,887.32
COST OF FINISHED GOODS PRODUCED			$485,641.10
ADD--DECREASE IN INVENTORY OF FINISHED GOODS:			
Inventory at January 1, 1918		$ 78,111.30	
Inventory at December 31, 1918		40,398.50	37,712.80
COST OF GOODS SOLD (Exhibit B)			$523,353.90

Solution to Problem 55

JOHN DOE
BALANCE SHEET, DECEMBER 31, 1918

ASSETS

CAPITAL ASSETS:			
Plant and Machinery	$10,000.00		
LESS--Reserve for Depreciation	1,000.00	$ 9,000.00	
Furniture and Fixtures	$ 700.00		
LESS--Reserve for Depreciation	35.00	665.00	$ 9,665.00
CURRENT ASSETS:			
Inventory of Merchandise		$ 9,500.00	
Accounts Receivable	$44,000.00		
LESS--Reserve for Bad Debts	2,200.00	41,800.00	
Cash:			
In Bank	$ 2,000.00		
On Hand	50.00	2,050.00	53,350.00
			$63,015.00

LIABILITIES AND CAPITAL

JOHN DOE--CAPITAL:	
Balance at January 1, 1918	$34,500.00
ADD--Investment	2,500.00
Interest on Capital	1,725.00
Profit for year	16,040.00
	$54,765.00
DEDUCT--Withdrawals	1,500.00
Balance at December 31, 1918	$53,265.00
CURRENT LIABILITIES:	
Accounts Payable	9,750.00
	$63,015.00

JOHN DOE
PROFIT AND LOSS ACCOUNT
FOR YEAR ENDING DECEMBER 31, 1918

Inventory at January 1, 1918	$ 8,500.00	Sales	$47,500.00
Purchases	14,750.00	Inventory at December 31, 1918	9,500.00
Wages	7,750.00		
Depreciation of:			
Plant and Machinery	1,000.00		
Furniture and Fixtures	35.00		
Bad Debts	2,200.00		
General Expense	5,000.00		
Net Profit from Operation	17,765.00		
	$57,000.00		$57,000.00
5% Interest on Capital at January 1, 1918	$ 1,725.00	Net Profit from Operation	$17,765.00
Surplus Net Profit	16,040.00		
	$17,765.00		$17,765.00

Comments on Problem 55

1. This is a simple problem in single-entry bookkeeping. The two points involved are the ascertainment of the sales and purchases for the period. This is done by building up the Accounts Receivable and Accounts Payable accounts from the information given, viz.:

ACCOUNTS RECEIVABLE

Jan. 1	Balance	$26,500.00	Dec. 31	Balance	$44,000.00
	Sales	47,500.00		Cash	30,000.00
		$74,000.00			$74,000.00

ACCOUNTS PAYABLE

Dec. 31	Balance	$ 9,750.00	Jan. 1	Balance	$ 7,500.00
	Cash	12,500.00		Purchases	14,750.00
		$22,250.00			$22,250.00

2. Five per cent is to be provided for bad debt reserve. Whether this is to be calculated on the sales or the outstanding accounts is not clear. The latter method would appear to be preferable under the circumstances.

3. The Profit and Loss account brings out the method of stating interest on capital, which is not an expense, but only a method of dividing profits.

Solution to Problem 56

NEW YORK--CURRENT ACCOUNT

Balance, July 1, 1918:			Cash		$17,100.00
Debtors	$5,820.00		Balance, December 31, 1918:		
Petty Cash	500.00		Debtors	$7,220.00	
Stock	3,450.00	$ 9,770.00	Petty Cash	500.00	
			Stock	4,300.00	12,020.00
Rents and Taxes		200.00			
Salaries and Wages		1,650.00			
Goods from Factory		11,500.00			
Net Profit		6,000.00			
		$29,120.00			$29,120.00

SAN FRANCISCO--CURRENT ACCOUNT

Balance, July 1, 1918:			Cash		$15,640.00
Debtors	$6,140.00		Balance, December 31, 1918:		
Petty Cash	500.00		Debtors	$7,415.00	
Stock	3,820.00	$10,460.00	Petty Cash	500.00	
			Stock	4,720.00	12,635.00
Rents and Taxes		175.00			
Salaries and Wages		1,520.00			
Goods from Factory		10,240.00			
Net Profit		5,880.00			
		$28,275.00			$28,275.00

MONTREAL--CURRENT ACCOUNT

Balance, July 1, 1918:			Cash		$15,250.00
Debtors	$7,240.00		Balance, December 31, 1918:		
Petty Cash	500.00		Debtors	$7,975.00	
Stock	3,650.00	$11,390.00	Petty Cash	500.00	
			Stock	4,500.00	12,975.00
Rents and Taxes		75.00			
Salaries and Wages		1,600.00			
Goods from Factory		10,350.00			
Net Profit		4,810.00			
		$28,225.00			$28,225.00

A COMPANY AND BRANCHES

GENERAL TRIAL BALANCE (BEFORE CLOSING), DECEMBER 31, 1918

(Compiled from data given in problem)

	HEAD OFFICE*		NEW YORK		SAN FRANCISCO	
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
Investment in Branch Houses (July 1, 1918)		$ 30,120.00				
New York--Current Account	$ 23,120.00	17,100.00				
San Francisco--Current Account	22,395.00	15,640.00				
Montreal--Current Account	23,415.00	15,250.00				
Factory		32,090.00				
Cash	47,990.00	6,720.00	$17,100.00	$17,100.00	$15,640.00	$15,640.00
Petty Cash			2,350.00	1,850.00	2,195.00	1,695.00
Debtors			7,220.00		7,415.00	
Stock (July 1, 1918)			3,450.00		3,820.00	
Sales				18,750.00		17,180.00
Returned Sales			200.00		100.00	
Allowances to Customers			50.00		40.00	
Goods from Factory			11,500.00		10,240.00	
Salaries and Wages			1,650.00		1,520.00	
Rents and Taxes			200.00		175.00	
Bad Debts					125.00	
Head Office--Current Account				6,020.00		6,755.00
	$116,920.00	$116,920.00	$43,720.00	$43,720.00	$41,270.00	$41,270.00

*Consists of items indicated by the sales branch house transactions. Other general office or factory transactions would be included if data were available.

A COMPANY AND BRANCHES
GENERAL TRIAL BALANCE, DECEMBER 31, 1918--Continued

	MONTREAL		COMBINED*	
	DEBIT	CREDIT	DEBIT	CREDIT
Investment in Branch Houses (July 1, 1918)				$ 30,120.00
New York--Current Account			$ 6,020.00	
San Francisco--Current Account			6,755.00	
Montreal--Current Account			8,165.00	
Factory				32,090.00
Cash	$15,250.00	$15,250.00	41,270.00	
Petty Cash	2,175.00	1,675.00	1,500.00	
Debtors	7,975.00		22,610.00	
Stock (July 1, 1918)	3,650.00		10,920.00	
Sales		16,325.00		52,255.00
Returned Sales	250.00		550.00	
Allowances to Customeres	30.00		120.00	
Goods from Factory	10,350.00		32,090.00	
Salaries and Wages	1,600.00		4,770.00	
Rents and Taxes	75.00		450.00	
Bad Debts	60.00		185.00	
Head Office--Current Account		8,165.00		20,940.00
	$41,415.00	$41,415.00	$135,405.00	$135,405.00

A COMPANY
STATEMENT OF PROFIT AND LOSS
FOR SIX MONTHS ENDING DECEMBER 31, 1918

	TOTAL	NEW YORK	SAN FRANCISCO	MONTREAL
SALES:				
On Account	$34,525.00	$12,500.00	$11,800.00	$10,225.00
Cash	17,730.00	6,250.00	5,380.00	6,100.00
TOTAL SALES	$52,255.00	$18,750.00	$17,180.00	$16,325.00
LESS--Returned Sales and Allowances	670.00.	250.00	140.00	280.00
NET SALES	$51,585.00	$18,500.00	$17,040.00	$16,045.00
COST OF SALES:				
Inventory at July 1, 1918	$10,920.00	$ 3,450.00	$ 3,820.00	$ 3,650.00
Goods from Factory	32,090.00	11,500.00	10,240.00	10,350.00
	$43,010.00	$14,950.00	$14,060.00	$14,000.00
LESS--Inventory at December 31, 1918	13,520.00	4,300.00	4,720.00	4,500.00
	$29,490.00	$10,650.00	$ 9,340.00	$ 9,500.00
GROSS PROFIT FROM SALES	$22,095.00	$ 7,850.00	$ 7,700.00	$ 6,545.00
DEDUCT--EXPENSES:				
Salaries and Wages	$ 4,770.00	$ 1,650.00	$ 1,520.00	$ 1,600.00
Rents and Taxes	450.00	200.00	175.00	75.00
Bad Debts	185.00	------	125.00	60.00
TOTAL EXPENSES	$ 5,405.00	$ 1,850.00	$ 1,820.00	$ 1,735.00
NET PROFIT	$16,690.00	$ 6,000.00	$ 5,880.00	$ 4,810.00

ANSWERS TO QUESTIONS

Answer to Question 136--Where the company is acting under a special resolution, the auditor should examine same and ascertain that it is in order. The auditor should also see that the statutory provisions have been complied with. This will enable him to vouch the necessary journal entries recording the alteration or reduction of the capital.

Where the scheme involves an alteration in the number of shares held by each shareholder, or in the nominal amount of such shares, or the conversion of one class of shares into another class, the auditor should check the necessary entries; and where new share ledgers have been opened, he should ascertain that each shareholder is duly credited with the amounts to which he is entitled. All canceled certificates should be inspected.

Answer to Question 137--From the minute book ascertain the authority upon which the commissions are being paid and the rate thereof, audit the voucher check in the usual manner, giving especial attention to the accuracy of the commission calculation. Note whether the vouchers are approved by someone familiar with the commission contracts.

Answer to Question 138--

(a) Purchases of additional equipment, being extensions to existing properties, represent legitimate charges to capital asset accounts. Therefore, the expenditure of $100,000 for locomotives, passenger cars, freight train cars, and other equipment is a proper capital addition. If this equipment were purchased to replace other equipment the necessary entries in respect of the book or record value of the equipment sold, destroyed, or dismantled should be made to relieve the property accounts and per contra debit the depreciation reserve account.

(b) The description of the expenditure clearly indicates that it was of an extraordinary nature and tended to prolong the life of the equipment against which provision for the accrued depreciation had been made. In other words, this expenditure tended to make good or arrest depreciation and therefore is a proper charge against the depreciation reserve that had been created for this purpose.

The auditor should examine the vouchers supporting the purchase of equipment. These vouchers should be examined as to authority and clerical accuracy. Assuming the concern made its own repairs, it will be necessary to verify the material and labor charges from the stores requisitions and pay-rolls. If burden has been added to prime cost it is especially important to inquire into the basis upon which such burden has been added with the view of ascertaining whether an excessive amount has been charged.

Answer to Question 139--

(a) Interest on bank loans, $3,700. If the moneys were borrowed for current working capital requirements of the business in connection with the manufacture and sale of its product, the expenditure would be a charge against the Profit and Loss account of the period. If the moneys were raised for the purpose of meeting payments in connection with construction work and represented interest on the loans during the period of construction, the expenditure would be a proper charge against the capital asset or property accounts.

(b) Legal and other expenses, $1,000, incurred directly in connection with the acquisition of certain property would be a proper charge against the capital asset accounts, being, as it is, a part of the cost of acquiring the property.

(c) Consulting engineer's salary $7,500. There is not sufficient information given in the question to enable one to determine whether or not the expenditure should be charged against capital or revenue. The whole question is, "On what kind of work did the engineer spend his time, i.e., in connection with additions and extensions to property or in the repair and upkeep of the property?" In the first-named case the charge would be against capital asset ac-

counts, and in the last-named case the charge would be against the Maintenance or Repair Expense account, or, in other words, against the Profit and Loss account of the current period. It may be that part of his time was spent on construction work and part on repair and upkeep work. In this case the charge would have to be apportioned between the two accounts.

It appears under the provisions of the trust deed that 80% of the cash expenditures for additions and betterments are fundable. Consequently in either case, the auditor must ascertain:

1. Whether the items in question constitute proper charges to additions and betterments.

2. Whether they have been paid for in cash inasmuch as cash expenditures only are fundable.

Answer to Question 140--Journal entries should be supported by a journal voucher properly approved. Documentary evidence supporting each entry and showing an approval of the transaction by an official should be called for even though formal journal vouchers are not used.

HOLDING COMPANIES

EARLY HOLDING COMPANIES--

1. SPECIAL CHARTER COMPANIES
   Pennsylvania Company--1870, by Pennsylvania
   American Bell Telephone Co.--1880, by Massachusetts

2. GENERAL LAWS
   First enacted in 1888 by New Jersey. Now in force in majority of states.

METHODS OF CONSOLIDATING--

1. MERGER. One of the original companies acquires the net assets of the other companies, vendors dissolving. Acquired properties operated as branch works or dismantled.
2. AMALGAMATION. A new company is formed to acquire the net assets of the consolidating companies' vendors dissolving. Acquired properties operated as branch works or dismantled.
3. HOLDING COMPANY. One of the old companies or a new company acquires a controlling interest in the capital stock of the consolidating companies. Original companies retain their corporate existence and operate separately.

BALANCE SHEET--Balance sheet of merged or amalgamated company and holding company contrasted as to information conveyed with regard to:

1. Relation of quick assets to fixed assets.
2. Relation of capital investment to fixed assets.
3. Working capital as represented by the excess of current assets over current liabilities.
4. Surplus available for dividends.

CONSOLIDATED BALANCE SHEET--A consolidated balance sheet does not, nor does it pretend to, represent the financial condition of any particular corporation, or, in fact, any legal entity whatsoever. It is a statement set up in balance sheet form which represents the true financial condition of a group of companies which from a practical point of view are in reality one organization. In the preparation of such a statement all items affecting the companies inter se are eliminated so as to present their financial position so far as the public is concerned.

"MODUS OPERANDI"--

1. On the consolidating working sheet the accounts are listed vertically and the companies horizontally, with additional horizontal columns for "Intercompany Adjustments" and "Consolidated Balance Sheet." Reverse method may also be used. The intercompany transactions to be eliminated are listed in the "Intercompany Adjustments" column. Similar assets and similar liabilities are aggregated and the totals listed in the "Consolidated Balance Sheet" column.

2. Heading of consolidated balance sheet should indicate clearly that that statement shows the condition of all the affiliated companies and not merely the holding company alone.

ADVANCES TO AND FROM AFFILIATED COMPANIES may consist of:

1. Loans by holding company to subsidiary, evidenced by open account or note.

2. Loans by subsidiary to holding company, evidenced by open account or note.

3. Loans by one subsidiary to another subsidiary, evidenced by open account or note.

The loans receivable and loans payable, being exactly equal, offset each other and neither is shown in the consolidated balance sheet.

DIVIDENDS--Dividends payable by an affiliated company which will be received in toto by another affiliated company are eliminated. If the entire dividend does not pass to the holding company, that proportion pertaining to parties outside the organization is shown as a current liability. That proportion of the dividends receivable not derived from an affiliated company is shown as a current asset.

INTERCOMPANY SALES AND PURCHASES--The amount due from affiliated companies for goods sold should equal the amount due to affiliated companies for goods purchased, and both are eliminated.

INTERCOMPANY NOTES RECEIVABLE DISCOUNTED--Where a note is signed by one affiliated company and discounted by another, the liability of the several companies considered as one organization is direct, not contingent, and would be shown as "Notes Payable."

INTERCOMPANY BOND OWNERSHIP--Holding company may own part or all of the subsidiaries' outstanding bonds, and the subsidiaries may own part or all of the holding company's bonds, or the bonds of other subsidiaries. In any event, the par value of the intercompany bonds owned by affiliated companies would offset the corresponding liability of the issuing affiliated companies, and on the consolidated balance sheet there would appear only those bonds of affiliated companies which were held by the public.

INTERCOMPANY STOCK OWNERSHIP AND GOOD-WILL--

1. Where a holding company acquires the shares of a subsidiary at book value, the investment account on the books of the holding company is exactly offset by the par value of the capital stock appearing on the books of the subsidiaries and the proportion of the surplus pertaining to those shares, and both are eliminated.

2. Where a holding company acquires the shares of a subsidiary at a price in excess of the book value, such excess represent intangible value in the nature of good-will. If possible, it should not be merged with tangible values. It cannot be considered as a charge to surplus as that procedure would treat the excess paid as a loss.

3. Where a holding company acquires the shares of a subsidiary at a price less than the book value the difference should be:

(a) Applied in reduction of any existing good-will, or
(b) In reduction of the valuation placed on "Cost of Properties."
(c) If there are no intangible values to be extinguished, may be shown as a capital surplus, but not as "Surplus" available for dividends.

4. Good-will in the consolidated balance sheet is used in its broadest sense, i.e., to represent any intangible value.

MINORITY STOCKHOLDERS--If the holding company does not own all the shares of its subsidiaries, the equity of the minority stockholders would consist of:

1. The par value of the capital stock held by the minority stockholders,

2. That proportion of the undistributed surplus to which they are entitled by virtue of their ownership of the aforementioned stock. This equity would be shown on the consolidated balance sheet thus:

MINORITY STOCKHOLDERS' INTEREST IN AFFILIATED COMPANIES:		
Capital Stock (par value)	$--------	
Surplus	--------	$--------

It is customary to aggregate the entire minority stockholders' interest in the various subsidiaries in the manner just indicated, and no effort is made to show the amount of such interest in any particular subsidiary.

SURPLUS (Undistributed Profits Available for Dividends)--

1. SURPLUS OF SUBSIDIARY AT DATE OF PURCHASE by holding company is part of the assets acquired, and should be applied in reduction of the holding company's investment account for the purpose of preparing a consolidated balance

sheet. Only the holding company's proportion of the profits earned after the date the controlling interest was acquired can be considered as Surplus available for dividends.

2. DATE OF PURCHASE is date contract was entered into and not the date the transfer was actually consummated, provided the purchaser had a legal existence at that date.

3. INTERCOMPANY PROFITS IN INVENTORIES consist of the profits made by an affiliated company on goods sold to another affiliated company, and on hand in the latter's inventory. Such profit is not earned (from the viewpoint of the organization) until a sale is made to a solvent debtor outside the organization. The intercompany profit should be deducted in toto from the surplus pertaining to the holding company. No portion can be deducted from the minority stockholders' interest in the surplus, since these profits are earned so far as the individual companies are concerned.

4. INTERCOMPANY PROFITS IN CONSTRUCTION consist of the profits made by an affiliated company on construction work performed for another affiliated company. Following the generally accepted practice that construction work performed by a company for itself should be valued at cost, it would seem that construction work performed by one unit for another should also be valued at cost within the organization. Intercompany profit should be excluded and, as aforementioned, should be deducted in toto from the surplus pertaining to the holding company because so far as the performing company is concerned, the profit is realized.

<u>OTHER METHODS OF STATING THE FINANCIAL POSITION OF HOLDING COMPANIES</u>--

1. Summarize the financial condition of the subsidiary under the heading of "Investment in Subsidiary."

2. Attach a balance sheet of the subsidiary as an exhibit supporting the asset of "Investment in Subsidiary."

3. Attach a columnar statement containing the balance sheets of the individual companies and a combined balance sheet (after eliminating all intercompany items) as an exhibit supporting the asset of "Investments in Subsidiary Companies Controlled."

4. Using the consolidated balance sheet form as first outlined, take up only the holding company's proportion of the assets and liabilities of the subsidiaries so as to avoid showing "Minority Stockholders Interest in Subsidiary Companies."

<u>WHEN IS A COMPANY A SUBSIDIARY</u>?--

1. An investment in shares of another company is a marketable investment in case of:

(a) Temporary investment of surplus funds in shares of another company.

(b) Company purchasing such shares as stock-in-trade.

2. An investment in shares of another company is a permanent investment in case of:

   (a) Purchase of shares as investment of reserve funds.
   (b) Purchase of shares for purpose of controlling facilities as in the case of a union depot company.

3. Relation of holding company and subsidiary arises where one company:

   (a) Owns a majority of the voting stock of another; and
   (b) Exercises the control obtained by virtue of such majority ownership.

N O P COMPANY & SUBSIDIARIES
CONSOLIDATING WORKING SHEET

DEBITS

ACCOUNT	A B CO.	C D CO.	N O P CO.	INTERCOMPANY ADJUSTMENTS	CONSOLIDATED BALANCE SHEET
Investment in Capital Stock of A B Co. 500 shares at $100			$ 50,000	(A)$50,000	
Investment in Capital Stock of C D Co. 250 shares at $100			25,000	(B) 25,000	
Cash	$ 500	$ 1,300	25,000		$ 26,800.00
Receivables	10,000	18,000			28,000.00
Inventories	14,500	21,200			35,700.00
Land	10,000	------			10,000.00
Buildings	25,000	------			25,000.00
Furniture & Fixtures	7,500	2,500			10,000.00
	$67,500	$43,000	$100,000	$75,000	$135,500.00

CREDITS

ACCOUNT	A B CO.	C D CO.	N O P CO.	INTERCOMPANY ADJUSTMENTS	CONSOLIDATED BALANCE SHEET
Accounts Payable	$16,000	$18,000			$ 34,000.00
Accrued Wages	1,500				1,500.00
	(50,000			(A)$50,000	
Capital Stock	(	25,000		(B) 25,000	
	(		$100,000		100,000.00
	$67,500	$43,000	$100,000	$75,000	$135,500.00

REFERENCES:

Dickinson, pages 176-186
Kester, Vol. 2, pages 600-619

F. L. Barnes & Co.
Trial Balance - General Ledger
January 1, 1918 and December 31, 1918
Profit and Loss Accounts

Ledger Page	Account	Working Papers	Per Books January 1, 1918 Dr	Per Books January 1, 1918 Cr	Per Books December 31, 1918 Dr	Per Books December 31, 1918 Cr	Adjustments Dr.	Adjustments Cr	Profit and Loss Dr.	Profit and Loss Cr.
301	Sales	30		324 795 48		399 753 04	(10) 350 00			399 403 04
311	Interest Received			81 82		287 52		(13) 224 24		511 76
[illegible]	Discounts on Purchases			2 567 00		3 126 09				3 126 09
315	Miscellaneous Income			3 243 88		2 219 14	(6) 100 00 (1) 17 50	(2) 26 78		2 128 42
[illegible]	Returns and Allowances		1 573 20		897 00		(5) 264 00		1 161 00	
[illegible]	Discounts on Sales	31	67 074 25		83 933 05				83 933 05	
[illegible]	Raw Materials used		106 825 49		140 034 26				140 034 26	
[illegible]	Direct Labor		48 324 97		62 663 80				62 663 80	
[illegible]	Indirect Labor		4 556 70		4 997 08				4 997 08	
[illegible]	Superintendence		8 451 89		10 129 16				10 129 16	
[illegible]	Depreciation		14 660 60		14 803 49		(10) 70 00		14 873 49	
[illegible]	Heat, Light and Power		12 567 81		12 428 90		(1) 56 00		12 484 90	
[illegible]	Taxes - Factory		1 942 33		2 413 00				2 413 00	
[illegible]	Repairs and Upkeep - Bldgs.		946 00		832 23			(9) 500 00	332 23	
[illegible]	Repairs and Upkeep - Mchy. & Equip.		1 477 11		1 528 75				1 528 75	
[illegible]	Miscellaneous Supplies used		2 347 80		3 320 18				3 320 18	
[illegible]	Miscellaneous Factory Expenses		3 396 13		1 714 12				1 714 12	
[illegible]	Inventories Work in Proc. & Fin. Stk.		71 436 18	83 539 38	83 539 38	103 097 41				19 558 03
[illegible]	Advertising - Magazines		8 425 11		11 876 07				11 876 07	
[illegible]	Advertising - Newspapers		4 973 20		5 897 11		(1) 281 18		6 178 29	
[illegible]	Miscellaneous Selling Expenses		4 012 11		4 274 29				4 274 29	
[illegible]	Officers' Salaries		10 500 00		12 500 00			(7) 200 00	12 300 00	
[illegible]	Office Salaries		8 452 00		11 247 00				11 247 00	
[illegible]	Bad Debts		542 01		- -		(5) 702 79		702 79	
[illegible]	Rent		3 124 00		3 204 99				3 204 99	
[illegible]	Inventory Depreciation		1 300 00		- -		(4) 615 90 (3) 942 28		1 558 18	
411	Miscellaneous General Expenses		1 212 31		1 587 12		(1) 64 13		1 651 25	
421	Interest Paid		8 321 18		6 218 10		(12) 3 000 00 (11) 212 07		9 430 17	
431	Federal Income Tax		1 000 00		- -		(14) 2 600 00		2 600 00	
281	Profit and Loss (see Sheet 1)		16 885 19		28 444 12				20 119 29	
	Net Profit and Loss Adjustments							8 324 83		
			414 227 56	414 227 56	508 483 20	508 483 20	9 275 85	9 275 85	424 727 34	424 727 34

COMPLETE ACCOUNTING COURSE--PART II

Lecture 28

CLOSING THE AUDIT; REPORTS

Problem 62

The Montauk Manufacturing Co. becomes insolvent and the receiver appointed to wind up its affairs has a balance sheet prepared from the books which shows the following values:

MONTAUK MANUFACTURING COMPANY
BALANCE SHEET, JULY 2, 1919

ASSETS			LIABILITIES	
Cash		$ 1,402	Bills Payable	$ 30,000
Bills Receivable	$ 2,108		Accounts Payable	65,460
Accounts Receivable	19,740	21,848	Interest on Bonds due July 2, 1919	2,700
Raw Material	$16,200		Bonds (Issued for factory site and building)	90,000
Partly Manufactured Goods	5,400		Taxes, Wages, etc., Due	2,500
Finished Wares	13,900			
Consumable Supplies	300	35,800		
Factory Site and Buildings		90,000		
Machinery	$50,000			
Tools and Appliances	7,000			
Boats	8,000			
Horses and Trucks	4,000			
Office Fixtures	600	69,600		
		$218,650		$190,660
Deficiency (Losses)		72,010	Capital Stock	100,000
		$290,660		$290,660

The machinery, boats, and horses and trucks are pledged on chattel mortgage to secure creditors to the amount of $45,000, $6,000, and $3,000, respectively.

The mortgagees of the machinery agree to purchase it for $30,000, and the other mortgagees agree to take over the chattels in full satisfaction, which offers are believed to exceed what the securities would realize on forced sale.

It is estimated that raw materials and partly made and finished wares can be sold for $29,000, while the consumable supplies are not in marketable quan-

tities; that the tools and appliances will bring $4,000, and the office furniture $500. The bills receivable are all good, but $1,640 of book debts are uncollectible. Customers' notes to the amount of $7,000 have been discounted and the maker of one of said notes for $340 has failed.

Prepare a statement of affairs and a deficiency account.

Problem 63

The Hampton Circle Swing Co. was organized in New York on April 1, 1912, with an authorized capital stock of $500,000, divided into 5,000 shares of the par value of $100 each. The certificate of incorporation was filed April 5.

At a meeting of the directors held on April 6, there was acquired from W. J. Hampton at a valuation of $500,000 all his right, title, and interest in various patents held by him on the Hampton Circle Swings.

In order to raise funds with which to exploit the invention, Mr. Hampton donated to the company 2,499 shares of stock. Of this, 2,250 shares were sold from time to time at an average price of 90, and 225 shares were used in giving a bonus of 10% in stock.

The parts necessary to erect and equip three swings were purchased from the Danielson Iron Co. The cost was $73,247.92, of which $50,000 was paid in cash. The labor incident to erection was paid for in cash and amounted to $45,386.58. One swing was installed at Coney Island at a cost of $39,544.83; one at Atlantic City at a cost of $41,275.17; and one at Fort George at a cost of $37,814.50. The privileges cost collectively $12,000. The net income from the operation of the swings for the season was: Coney Island $12,273.85 (sold before Labor Day for $50,000); Atlantic City $2,863.15 (installation not completed until after July 4); Fort George $6,743.35. The salaries and expenses of the company from April 1 to September 30, 1919, were $18,787.59. The balance on account was paid to the Danielson Iron Co. and $2,000 was paid for a privilege at Ocean City for the season 1913.

Prepare:

(a) Journal entries opening the books of the Hampton Circle Swing Co. and covering subsequent transactions.

(b) Balance sheet, September 30, 1912.

QUESTIONS ON AUDITING

Question 151--The profits of a corporation with a paid-up capital of $5,000,000 amount to $337,193.08 for a given year, without allowing for its mortgage interest. At the end of the previous financial year there was left a balance of undivided profits of $27,806.92.

Its 4% mortgages are $500,000 and its 6% mortgages are $750,000. How much must be taken from the previous year's surplus balance to pay the stockholders a dividend of 6%?

Question 152--Is it necessary for depreciation to be written off the accounts of a company, whose property is of a wasting nature, such as a cemetery, before declaring a dividend? State your reasons for your answer.

Question 153--Specify some of the closing entries to be made, after the agreement of the trial balance in the books of an architect's business in which two partners are interested.

Question 154--The secretary of a company, who has complete control over the books and cash, has absconded, and the directors instruct you to examine the accounts with a view to ascertaining whether there are any irregularities. What steps would you take to satisfy yourself on this point?

Question 155--What authority would you require as auditor for passing the remuneration of the directors of a company, and to what book would you refer to ascertain the names of the persons entitled thereto?

Solution to Problem 57

The following errors in principle and misstatement of facts appear in the balance sheet and statement of profits and income of the American Optimist Co.

PROPERTY ACCOUNT

1. If the necessary data are available, Patents and Good-Will should be separated from the tangible assets.

2. The Discounts and Commission on Bonds should be shown as a deferred charge except as to that portion of the total discount and commission which relates to the period of construction. Bond discount and commission is an addition to the nominal rate of interest paid and should be amortized over the term of the bonds.

3. The Expenditures in Dismantling the plant at Hoboken are not proper charges to Property account. The conservative treatment would be to write off these charges against the operating expenses of the current period, but where the depreciation reserve is adequate the cost of dismantling should be charged thereagainst.

4. The charges in respect of Remodeling and Reconstructing Department C apparently take the form of improvement expenditures which, strictly speaking, should be apportioned between (a) Property and (b) Deferred Charges to Operating.

CURRENT ASSETS

5. Stocks and Bonds in Treasury at par ($2,000,000) apparently refers to the company's own securities which have been reacquired. These treasury securities should be deducted from the authorized issue of stock and bonds respectively in order to set out the amount issued and outstanding.

6. Investments in other Companies held as Permanent Investments ($375,000) are not current assets and should be set out separately between capital and current assets under the caption of Permanent Investments.

7. Inventories of Raw Materials and Supplies ($2,600,000) and Finished Goods and Work in Progress ($500,000) are properly set out if the cost is less than the market.

8. Consigned Merchandise ($150,000). To value such stocks at the selling value (presumably estimated) is to take credit for the profit before it was earned, which is contrary to the accounting principle of "anticipate no profits and provide for all possible losses." Should be valued at cost or market, whichever is the lower.

9. Contracts under Way ($1,500,000). These should be valued on the same basis as the other inventories. The method adopted by the company results in the anticipation in the current period of all the profit which may be earned up to the date of completion. And if the estimated cost to complete should prove to be an underestimate, a profit has been anticipated which will never be earned. If the contracts can be split into independent sections it would be permissible to take up the profit on each section as completed.

10. Accounts and Bills Receivable--Gross ($1,400,000). The use of the word "gross" would indicate that no provision has been made for bad and doubtful accounts, discounts, allowances, etc. Failure to do so has the effect of overstating both the Accounts and Bills Receivable and Surplus accounts on the balance sheet and the net profits for the current year.

11. Cash and other Cash Assets, including Deposits with the Trustee under Mortgage ($650,000). The point here seems to be that the deposits with the trustee have been included among the free cash assets. The amount of the deposits should be set out separately as such between Permanent Investments and the Current Assets. Any part of the deposits so called representing bonds redeemed, should be deducted from the liability of Bonded Indebtedness Outstanding.

DEFERRED CHARGES

12. Whether the advertising expenses can be properly carried forward depends on the character of the business and of the advertising. If it be a seasonal business, or if the advertising represents an extraordinary campaign the benefits from which will accrue in the following period, it may be permissible to carry forward the expenditure. As a general rule, where advertising expenditures are deferred, it is advisable to provide a reserve for the expenses to be incurred in collecting the outstanding receivables.

The items referred to in (3) and (4) should be included under this caption.

CAPITAL STOCK AND BONDED INDEBTEDNESS

13. The amount of the treasury or unissued stock should be deducted from the amount of $5,000,000, assuming that the latter amount represents the authorized issue.

14. The amount of the bonds taken up or redeemed to December 31, 1918, should be deducted from the original issue in order to set out the liability at the latter date.

RESERVE FUNDS

15. The caption Reserve Funds is a misnomer inasmuch as Reserve Funds refer to the assets comprising the reserves if such assets are ear-marked. The proper caption is Reserves.

16. If the tangible property assets (other than land) could be set out separately, it would be better treatment to deduct the Depreciation and Accruing Renewal Reserve therefrom instead of showing the same on the liability side of the balance sheet. Should it be inadvisable to so separate the Property account the treatment already adopted appears to be the better one.

17. Reserve for Unaudited Bills ($50,000). Should have been included as part of the current liabilities inasmuch as it represents what are ordinarily termed outstanding liabilities.

SURPLUS

18. Adjustments ($250,000). The item being deducted from the Surplus account indicates that the amount represents adjustments in respect of the operations prior to January 1, 1918. Assuming this to be the case, it still appears to be desirable to describe the item more fully.

19. The Net Earnings of $1,500,000 are correctly stated subject to the remarks under the heading of Statement of Profits and Income.

20. Appropriation of $100,000 for Bond Sinking Fund should have been shown as a deduction in the statement of profits and income for the year ending December 31, 1918, as the appropriation is usually made out of the current profits rather than the Surplus account. If the resolution stated that an appropriation of surplus should be made for Bond Sinking Fund the method given would be correct.

21. Depreciation ($150,000). Where the appropriation represents approximately the current accruing depreciation it should be considered as a manufacturing expense and thus enters into the Cost of Sales as shown by the statement of profits and income except for that portion chargeable to Finished Product and Work in Progress Inventories at December 31. However, judging from the amount involved the appropriation appears to be an arbitrary amount which is materially less than the approximate depreciation accruing during the period. In such cases it may be advisable to show the provision as an appropriation of surplus rather than as an operating expense.

STATEMENT OF PROFITS AND INCOME

22. Gross Sales and Consignments ($8,575,000). This item is overstated to the extent of the selling price of the unsold consignments included therein. The latter should be eliminated.

23. Cost of Sales ($6,825,000). This item is overstated to the extent of the cost value of the unsold consignments referred to in (22).

24. Profits on Contracts in Progress ($275,000) apparently represents an estimated anticipated profit which should be excluded from the statement of profits and income as mentioned in (9).

25. Profits on Bonds Purchased ($15,000). If this represents a profit on the purchase and sale of bonds, the item is correctly stated. If it represents the difference between the par value of bonds purchased for sinking fund or for redemption, the proper treatment depends on the circumstances. The trust indenture may provide that such profits be credited to the Sinking Fund Reserve.

If not it should be shown as extraordinary income after interest charges have been deducted.

26. Taxes ($25,000). If this item represents taxes assessed on property used in manufacturing operations it should be treated as a manufacturing expense and hence included as part of Cost of Sales except as to that part chargeable to Finished Product and Work in Progress inventory.

27. Interest Charges ($250,000). The net profits for the year should be arrived at before deducting interest charges.

Solution to Problem 58

WILLIAM JONES--CAPITAL ACCOUNT

Balance	$39,023.96	Cash	$ 6,250.00
		"	8,042.68
		"	8,143.23
		"	8,243.77
		"	8,344.28
	$39,023.96		$39,023.96

OFFICE FURNITURE

Purchased from Hewson & Fellows	$1,093.75

INVENTORY OF MERCHANDISE

Purchased from Hewson & Fellows	$16,892.00

ACCOUNTS RECEIVABLE

Purchased from Hewson & Fellows	$18,200.00

RESERVE FOR BAD DEBTS

		Provision for Bad Debts	$1,365.00

CASH

Investment	$ 6,250.00	Creditors Paid			$ 6,250.00
"	8,042.68	Hewson & Fellows, Vendor			8,042.68
"	8,143.23	Notes Payable retired:			
"	8,243.77	DATE	PRIN.	INT.	
"	8,344.28	4/1	$8,042.69	$100.54	8,143.33
		7/1	8,042.69	201.08	8,243.77
		10/1	8,042.69	301.59	8,344.28
	$39,023.96				$39,023.96

CREDITORS

Liabilities Paid	$6,250.00	Assumed from Hewson & Fellows	$6,250.00

NOTES PAYABLE

Cash Paid	$ 8,042.69	Notes issued to Hewson & Fellows:		
"	8,042.69	4/1	$8,042.69	
"	8,042.69	7/1	8,042.69	
		10/1	8,042.69	$24,128.07
	$24,128.07			$24,128.07

INTEREST ON NOTES PAYABLE

Cash Paid	$100.54		
"	201.08	Balance	$703.21
"	301.59		
	$703.21		$703.21

HEWSON & FELLOWS--VENDOR ACCOUNT

Cash	$ 8,042.68	Net Assets Purchased	$32,170.75
Notes Payable Issued	24,128.07		
	$32,170.75		$32,170.75

ANSWERS TO QUESTIONS

Answer to Question 141--The claim referred to is apparently in the nature of a contingent liability. As a general rule, all such liabilities should be stated in a footnote on the face of the balance sheet. Under the circumstances given it will be necessary for the auditor to qualify his certificate, and to avoid this the directors may accede to his request.

Answer to Question 142--

(a) Directors are elected by the stockholders to act as the managers of the company. The board of directors determines the policies to be followed and carries out these policies through the officers appointed by them.

(b) The auditor should pay special attention to all transactions arising between the company and the directors as individuals.

(1) A director may sell goods on behalf of the company, but the sale must be made in the usual manner and should not be detrimental to the company's interests. The auditor must guard against the milking of a company by a director for his personal aggrandizement.

(2) It appears that unless their powers are specifically limited by statute, by-laws, or a resolution adopted at a stockholders' meeting, the directors can in their discretion vote to pay themselves the traveling expenses incurred in attending directors' meetings. If this be done, the auditor should ascertain the names of the directors present at each meeting so as to satisfy himself that traveling expenses are not being paid to absent directors. It would be difficult for the auditor to pass upon the reasonableness of these expenses where the bills are approved by the board.

(3) The directors may in their discretion vote to waive half or all of their fees. Inasmuch as a resolution has been passed waiving half of the directors' fees, the auditor should be careful to note that only half of the usual fees are paid during the current year.

Answer to Question 143--The directors' remuneration is commonly fixed by the by-laws, and in such cases the by-laws should be perused to determine the amount to be paid and whether it is payable to all directors or only to those present. If the point is not covered in the by-laws, the amount to be paid and to whom it should be paid would be stipulated by a resolution adopted by the board of directors. The minute book would give the names of the directors present at each meeting.

Answer to Question 144--Ascertain how each note receivable has been disposed of: (1) by receipt of cash from maker; (2) by receipt of cash when discounted; (3) by transfer to a creditor or other party to apply on account; (4) by renewal.

At the date of the audit it may be usually assumed that all notes maturing prior to that date have been paid by their makers unless notice of default has been received. The unmatured notes represent a contingent liability which should be expressed on the balance sheet.

All notes not discounted should be on hand and produced for inspection. If out for collection verification may be made through correspondence with the attorneys.

Answer to Question 145--

(a) Shop wages paid. The first step in verification of this class of expenditure is to make an inquiry into the system of internal check surrounding the pay-roll disbursements. Much depends upon the adequacy of the system of internal check. Pay special attention to the system of paying off. Ascertain how envelopes not called for on pay-day are handled. Comparison of the time tickets or other record of workmen's time should be made with the pay-roll book, extensions and footings verified, and the totals of each sheet traced to the recapitulation or summary and, finally, the grand total traced to the general ledger accounts. Properly authorized and approved memoranda in respect of new employees engaged, changes in rates, and transfer from one department to another should be examined.

The pay-rolls should bear the certification of responsible employees as to the correctness of the various parts of the work. Finally the rolls should bear the approval of a responsible official.

(b) Dividends paid. Reference should be made to the minutes of the meeting of the directors at which the dividend was declared. Canceled voucher checks or other evidence should be examined in respect of the payment of the dividends.

(c) Merchandise purchases. Examine the invoices supporting the entries noting evidence as to:

1. Receipt of goods of proper quality
2. Correctness of prices and terms
3. Correctness of clerical accuracy of invoice
4. Approval for payment
5. Correctness of accounts charged
6. Whether all cash discounts are taken

Special attention should be given to the manner in which an invoice is put through. Approvals are apt to be perfunctory, especially where rubber stamps are used. If this condition is found, a rather thorough check of the details is essential. All invoices examined should be canceled at the time by the use of a rubber stamp or other device to prevent one invoice being presented in support of two entries.

REFERENCES:
Montgomery, pages 235-292
Wildman, pages 159-177

F. L. Barnes & Co.

Adjusting Journal Entries to bring Books into Conformity with Report.

page 1

Particulars		Dr.	Cr.
(1)			
Office Furniture and Fixtures	P/C Vou. # 1561	$ 78.80	
Miscellaneous Restaurant Expense	" " 1543	17.50	
Factory Heat, Light and Power	" " 1580	56.00	
Office Repairs	" " 1575	64.13	
Advertising - Newspapers	" " 1531	281.18	
To- Accounts Payable			$ 497.61
November and December 1918 invoices paid in January 1919.			
(2)			
Cash in Bank		$ 26.78	
To- Profit and Loss 1918			$ 26.78
1915 and 1916 Payroll checks written off.			
(3)			
Profit and Loss 1918		$ 942.28	
To - Inventory Reserve			$ 942.28
Markdown in the following accounts -			

Account	Cost	Market	Difference
Lumber (Yard)	$ 11,584.29	$ 10,758.28	$ 826.01
Lumber (Factory)	1,028.96	1,001.19	27.77
Lumber (Kiln)	2,147.18	2,058.68	88.50
	$ 14,760.43	$ 13,818.15	$ 942.28

Particulars	Dr.	Cr.
(4)		
Profit and Loss 1918	$ 615.90	
To - Inventory Reserve		$ 615.90
Markdown in Inventory of Work in Process to give expression to additional cost of		

Job-Ticket	Style	Est. Cost	Av. Cost	Markdown
18341	187	$ 5,287.12	$ 4,875.00	$ 412.12
18349	180	653.78	450.00	203.78

Particulars	Dr.	Cr.
(5)		
Returns and Allowances	$ 264.00	
Bad Debts	702.79	
To- Accounts Receivable		$ 773.00
Instalment Accounts Receivable		193.79
Uncollectible Accounts Receivable as per lists thereof.		

F. L. Barnes & Co.

Adjusting Journal Entries – page 2

Particulars	Dr.	Cr.
(6)		
Profit and Loss	$ 100.00	
To – Investment in Improved Kitchen Cabinet Co		$ 100.00
10 shares stock purchased July 1, 1918 at 90. Investment was charged at par and P+L credited; this entry to reduce investment to cost.		
(7)		
Buildings	$ 200.00	
To – Officers' Salaries		$ 200.00
To adjust salary of H. E. Barnes for the month of July 1918; ½ of his time being devoted to the construction of Building C		
(8)		
Buildings	$ 1,264.67	
To – Buildings – Equipment and Fixtures		$ 1,264.67
Transfer cost of skylights installed in 1918 to Buildings account.		
(9)		
Buildings – Equipment and Fixtures	$ 500.00	
To – Repairs and Up-keep – Buildings		$ 500.00
Cost of 2 Johnson heating furnaces charged to Repairs in error.		
(10)		
Profit and Loss	$ 70.00	
Reserve for Depreciation – Machinery	180.00	
Sales	350.00	
To – Machinery		$ 600.00
Lathe scrapped during year and proceeds credited to sales.		
(11)		
Interest Paid	$ 212.07	
To – Accrued Interest on Notes Payable		$ 212.07
Interest on Bank Loans and Trade Notes at Dec. 31, 1918		

F. L. Barnes & Co.

Adjusting Journal Entries - page 3

Particulars		Dr.	Cr.
(12)			
Interest Paid		$ 3,000.00	
To - Interest Accrued on Bonds			$ 3,000.00
Interest accrued from 7/1/18 to 12/31/18			
(13)			
Accrued Interest Receivable		$ 224.24	
To - Interest Received			$ 224.24
Interest Accrued as follows =			
Notes Receivable	$ 35.61		
Liberty Bonds	188.63		
(14)			
Federal Income Tax		$ 2,600.00	
To - Federal Taxes accrued			$ 2,600.00
Estimated Income + Profits Taxes for 1918.			

F. L. Barnes & Co.
Trial Balance - General Ledger
January 1, 1918 and December 31, 1918
Balance Sheet Accounts

Ledger Page	Account	Working Papers	Per Books January 1, 1918 Dr.	Per Books January 1, 1918 Cr.	Per Books December 31, 1918 Dr.	Per Books December 31, 1918 Cr.	Adjustments Dr.	Adjustments Cr.	Balance Sheet Dr.	Balance Sheet Cr.
1	Petty Cash	2	500.00		500.00				500.00	
3	Cash in Bank	3	11,233.55		14,107.05		2 26.78		14,133.83	
11	Raw Materials	8	20,870.54		24,749.21				24,749.21	
31	Work in Process	9	31,640.91		27,553.59				27,553.59	
51	Finished Stock	10	51,898.47		75,543.82				75,543.82	
71	Inventory Reserve	11		1,634.58		1,634.58		4 615.90 3 942.28		3,192.76
73	Accounts Receivable	4	14,630.80		10,823.22			5 773.00	10,050.22	
77	Instalment Accounts Receivable	5	3,065.42		2,196.80			5 193.79	2,003.01	
85	Notes Receivable	6	1,460.02		1,978.09				1,978.09	
89	Reserve for Bad Debts	7		1,028.90		502.40				502.40
91	Accrued Interest Receivable	6 14	- -		- -		13 224.24		224.24	
101	Unexpired Insurance	12	3,074.80		3,154.81				3,154.81	
105	Prepaid Interest	13	- -		200.00				200.00	
107	Prepaid Rent	13	- -		1,120.00				1,120.00	
111	Liberty Loan - 3rd Issue	14	- -		15,000.00				15,000.00	
113	Liberty Loan - 4th Issue	14	- -		5,000.00				5,000.00	
115	Investment - Improved Kit. Cab. Co.	15	18,100.00		19,100.00			6 100.00	19,000.00	
117	Investment - D. B. Story Mfg. Co	16	32,243.88		33,036.84				33,036.84	
121	Cash in hands of S. F. Trustee	17	10,000.00		10,316.77				10,316.77	
123	Investments in hands of S. F. Trustee	17	- -		10,094.00				10,094.00	
151	Land	18	32,250.00		32,250.00				32,250.00	
153	Buildings	19	89,727.27		98,317.71		8 1,264.67 3 200.00		99,782.38	
157	Building Equipment & Fixtures	20	8,854.52		10,119.19		9 500.00	8 1,264.67	9,354.52	
161	Machinery	20	108,951.36		110,814.08			10 600.00	110,214.08	
167	Office Furniture & Fixtures	21	2,208.20		2,912.15		1 78.80		2,990.95	
171	Goodwill	23	50,000.00		50,000.00				50,000.00	
173	Reserve for Depreciation	22		39,846.79		54,650.28	10 180.00			54,470.28
201	Notes Payable (Bank Loans)	24		62,000.00		75,000.00				75,000.00
211	Trade Notes Payable	24		2,455.80		3,689.47				3,689.47
219	Vouchers Payable	25		9,896.33		15,074.58				15,074.58
227	Accounts Payable	25		476.75		1,275.31		1 497.61		1,772.92
241	Accrued Int. on Notes Payable	24		67.80		- -		11 212.07		212.07
243	Federal Taxes Accrued	26		1,000.00		- -		14 2,600.00		2,600.00
247	State Taxes Accrued	25		1,954.80		2,617.54				2,617.54
251	Accrued Bond Interest	17		3,000.00		- -		12 3,000.00		3,000.00
261	First Mortgage 6% Bonds	27		100,000.00		100,000.00				100,000.00
263	Sinking Fund Reserve	17		10,000.00		20,410.77				20,410.77
271	Capital Stock	28		230,000.00		250,000.00				250,000.00
275	Surplus	29	10,000.00	25,057.80	10,000.00	27,088.28			10,000.00	27,088.28
281	Profit and Loss (see sheet 2)			16,885.19		28,444.12				20,119.29
291	Dividends	29	4,600.00		11,500.00				11,500.00	
	Net Profit and Loss Adjustments						8,324.83			
			505,304.74	505,304.74	580,387.33	580,387.33	10,799.32	10,799.32	579,750.36	579,750.36

COMPLETE ACCOUNTING COURSE--PART II

Lecture 29

OTHER KINDS OF AUDITS

Comments on Audit Problem

The student now has in his possession a file of working papers for which he should prepare an index. The papers may be arranged alphabetically (commencing with accounts payable) or in the same order as the items appear on the trial balance or balance sheets, etc.

In addition to the working papers which have been presented, a balance sheet audit would ordinarily require:

1. Abstract of the minutes of the board of directors at least during the past year and up to the date of the audit. It may be desirable--as in this case--to go back to the inception of the organization. (See Montgomery, pages 179-181.)

2. Certificates from banks showing, (a) amounts on deposit at close of year and in some cases at the date of the examination of the cash, and (b) liabilities in the way of bank loans, discounted paper, etc., that would likely affect the financial position of the company.

3. Certificates from officers in charge of taking inventory and pricing same to the effect that amounts are correct and that values are the lower of cost or market.

4. Certificates from officers stating that all known liabilities at the close of the year had been put on the books as of that date.

5. Analyses of some of the leading profit and loss accounts, such as Repairs, Officers' and Office Salaries, Interest Paid and Received, Heat, Light, and Power, etc. The nature of the analysis would depend on the circumstances of the case, i.e., the care with which distributions had been made and the correctness of the theory underlying the distributions. Comparison with the corresponding account of the previous year is suggestive.

6. Comments of a varied nature covering any point arising during the audit. These will include criticisms of the system in use, whether they deserve mention in the report or not; data on the nature of the examination of the cash book, voucher record, ledgers, etc., in the way of testing the accuracy of the records; missing vouchers, canceled checks, or other records that were missing or in which discrepancies existed, etc. These comments should be made not in phrases, words, or abbreviations, but in full English sentences so that six months hence there will be no doubt as to their meaning. Notes of this kind made during an audit will determine whether an auditor is capable of discriminating between relevant and irrelevant facts. Mention of the latter should, of course, be avoided on the working papers.

7. At the close of an audit a summary may be made for the auditor's files which may be used in connection with a future audit of the same concern. Comments on the system, names, and duties of the officers and certain employees, and other informational points may be followed by a program of the audit, showing the nature of the work done and the approximate time of each operation performed, together with recommendations as to future audits.

8. In this case it should be assumed that separate examination has been made of the subsidiary company's accounts, with the results as summarized in the working papers. Because of the similarity of working papers those pertaining to the accounts of the D. B. Story Manufacturing Co. have been omitted.

<u>Assignment in Connection with F. L. Barnes & Co. audit</u>

Exhibits have been prepared for the report as follows:

Exhibit	
I	Consolidated balance sheet
II	Consolidated income statement
III	Comparative balance sheets of F. L. Barnes & Co. December 31, 1917, and December 31, 1918
IV	Comparative profit and loss statements of F. L. Barnes & Co. for the years ending December 31, 1917, and December 31, 1918
IV-a	Comparative statements of cost of sales for the years ending December 31, 1917, and December 31, 1918

Write a brief report summarizing the findings during the audit and including the following items:

(a) Analysis showing causes of changes in profits during the last year as compared with the previous year.

(b) Any comments on the profit and loss statement which you think important to call to the attention of the management. It should be remembered that the present audit is a regular yearly audit, and your remarks should be governed accordingly.

(c) Condensed statement of condition prepared from the balance sheet of December 31, 1918, bringing out the ratio between current assets and liabilities.

(d) Comments on the principal balance sheet items.

(e) Statement showing causes of change in financial condition (application of funds) from January 1, 1918, to December 31, 1918.

(f) Special comments which you think desirable in connection with the conduct of the audit, including the nature of the detailed audit made.

Solution to Problem 59

CENTRAL MANUFACTURING CO. AND SUBSIDIARIES
CONSOLIDATING WORKING SHEET

ASSETS

ACCOUNTS	J. DOE & CO.	R. ROE & CO.	CENTRAL MFG. CO.	INTERCOMPANY ADJUSTMENTS	CONSOLIDATED BALANCE SHEET
Plant & Equipment	$ 50,000	$ 97,500			$147,500
Inventories	30,000	47,400			77,400
Advances to R. Roe & Co.	3,500			(A)$ 3,500	
Advances to Cent. Mfg. Co.		7,500		(B) 7,500	
Customers	25,000	25,000			50,000
Cash	5,000	3,850	$ 59,000		67,850
Notes Rec. of J. Doe & Co.			8,500	(C) 8,500	
Dividends Receivable			3,000	(D) 3,000	
Investment in the Capital Stock of John Doe & Co.:					
750 shares at $100:			100,000		
Par Value				(E) 75,000	
Good-Will					25,000
Investment in the Capital Stock of Richard Roe & Co.:					
1000 shares at $100:			90,000		
Par Value				(F) 100,000	
Good-Will					*10,000
	$113,500	$181,250	$260,500	$197,500	$357,750

* Should be shown in red.

LIABILITIES

ACCOUNTS	J. DOE & CO.	R. ROE & CO.	CENTRAL MFG. CO.	INTERCOMPANY ADJUSTMENTS	CONSOLIDATED BALANCE SHEET
Capital Stock:					
Doe	$ 75,000			(E)$ 75,000	
Roe		$125,000		(F) 100,000	(M)$ 25,000
Central			$250,000		250,000
Accounts Payable	27,000	46,500			73,500
Notes Payable--					
Central Mfg. Co.	8,500			(C) 8,500	
Dividends Payable	3,000			(D) 3,000	
Advances from J. Doe & Co.		3,500		(A) 3,500	
Advances from R. Roe & Co.			7,500	(B) 7,500	
Surplus		6,250	3,000		(M) 1,250
					8,000
	$113,500	$181,250	$260,500	$197,500	$357,750

Comments on Problem 60

1. On account of the large amount outstanding at December 31, 1918, notes payable have not been considered as part of the working capital. In all probability the funds obtained from the sale of bonds were used to retire the notes payable.

2. Note the manner in which the discount on bonds sold has been dealt with.

Solution to Problem 61

X Y Z AND P Q COMPANIES
CONSOLIDATING WORKING SHEET

	DEBITS			
	X Y Z CO.	P Q CO.	INTERCOMPANY ADJUSTMENTS	CONSOLIDATED BALANCE SHEET
Real Estate	$ 50,000.00	$ 25,000.00		$ 75,000.00
Buildings, Plant, and Equipment	75,000.00	45,000.00		120,000.00
Good-Will	25,000.00	---------		(B) 25,000.00
Investment in P Q Co.: 1,000 Shares, Par Value $100:	150,000.00			
Par Value			(A)$100,000.00	
Surplus			(A) 25,000.00	
Good-Will				(B) 25,000.00
Inventories	80,000.00	20,000.00		100,000.00
Accounts Receivable	60,000.00	70,000.00	(B) 15,000.00	115,000.00
Cash	10,000.00	15,000.00		25,000.00
	$450,000.00	$175,000.00	$140,000.00	$485,000.00

	CREDITS			
	X Y Z CO.	P Q CO.	INTERCOMPANY ADJUSTMENTS	CONSOLIDATED BALANCE SHEET
Accounts Payable	$ 50,000.00	$ 50,000.00	(B) $ 15,000.00	$ 85,000.00
Loans	50,000.00	----------		50,000.00
Capital Stock:				
X Y Z Company	250,000.00	----------		250,000.00
P Q Company	----------	100,000.00	(A) 100,000.00	
Surplus:				
X Y Z Company	100,000.00	----------		100,000.00
P Q Company	----------	25,000.00	(A) 25,000.00	
	$450,000.00	$175,000.00	$140,000.00	$485,000.00

(A) Elimination of book value of investment in P Q Company, as follows:

Purchase Price		$150,000.00
DEDUCT--Par Value of Shares Acquired	$100,000.00	
Surplus at date of Purchase	25,000.00	125,000.00
Excess of Purchase Price over Book Value termed Good-Will		$ 25,000.00

(B) Elimination of intercompany accounts receivable and accounts payable.

X Y Z AND P Q COMPANIES
CONSOLIDATED BALANCE SHEET, JANUARY 1, 1919

ASSETS

CAPITAL ASSETS:		
Real Estate	120,000.00	
Buildings, Plant, and Equipment	$ 75,000.00	
	$195,000.00	
Good-Will	50,000.00	$245,000.00
CURRENT ASSETS:	$100,000.00	
Inventories	115,000.00	
Accounts Receivable	25,000.00	240,000.00
Cash		
		$485,000.00

LIABILITIES

CAPITAL STOCK OF X Y Z COMPANY ISSUED AND OUTSTANDING		$250,000.00
CURRENT LIABILITIES:		
Bank Loans	$ 50,000.00	
Accounts Payable	85,000.00	135,000.00
SURPLUS		100,000.00
Total Liabilities, Capital Stock, and Surplus		$485,000.00

ANSWERS TO QUESTIONS

Answer to Questions 146-147--

(a) Examine voucher and check, together with bill of Rapid Typewriter Co. showing purchase price of new machine and exchange value of the old one. The Property account should contain the cost price of the new typewriter. The original cost of the replaced typewriter should be credited to Property, and the loss on the exchange charged to Depreciation Reserve (if provision has been made) or Operating Expense.

(b) Require deed and abstract of title. If there is any question in regard to title or incumbrance, demand a certificate from the firm's attorney. Also examine the voucher and check representing payment.

(c) Ask for contract with Automatic Sprinkler Co., which will give information as to purchase price and mode of payment. Examine voucher and check showing the instalment payment. The total cost of the system should appear as a charge to Property and the unpaid instalments should be set up as a liability.

(d) Examine contract for the purchase of stumpage, which will give the purchase price; also examine voucher and check.

(e) Ask for "bought bill" of Safety Trust Co., as well as voucher and check showing payment, and call for the bonds purchased.

(f) Analyze material and labor charges to see if they are made at cost. Note whether a percentage for overhead has been included and, if so, the character of the items making up the overhead. Note whether an interdepartmental profit has been added.

(g) Thomas Jones should send weekly reports of his expenses to the office. These can be supported by hotel and other receipts. They should be approved by some official whose duty it is to supervise the traveling expenses of the salesmen. Examine voucher and check.

(h) Examine duplicate discount memorandum and note whether credit has been received in the pass book. If there is question as to whether the note actually was discounted, communicate with the bank.

Answer to Question 148--Stamp or otherwise cancel each voucher when audited. The imprint commonly used contains the name of the auditing firm, name or initials of the audit clerk, and the date of the audit.

Answer to Question 149--A voucher and voucher check should support each payment. Examine the voucher check as to date, indorsements, amount, and signature of drawer of check. To the voucher or voucher check should be attached the documentary evidence upon which the payment is authorized, such as invoice from creditors, notes paid, etc. These should be examined as to date and nature of items in invoice. Invoices should bear the following certificates:

1. Receipt of goods by receiving clerk
2. Prices and terms O K by purchasing agent
3. Extensions and footings O K by bookkeeper
4. Payment approved by proper authority

Usually bank statements and pass books do not bear the certification of the bank as to the balance to the credit or debit of an account at a certain date. Moreover, an auditor is not in a position to know that the bank statement handed him and purporting to be the one submitted by the bank is genuine. Therefore, out of precaution an auditor usually requests that a certificate, over the signature of a responsible officer of the bank be furnished him as to the balance in a certain account at a given date.

Answer to Question 150--

(a) In order to vouch allowances made to customers, the auditor should test entries of any consequence with credit memoranda and refer to the correspondence or to any other evidence available. The allowances should be footed and the totals checked with the general ledger. In addition it should be seen that the allowances are properly authorized by responsible officials.

(b) In order to vouch calls in arrear, the balances on the shareholders' accounts in the share ledger should be checked and agreed with the balances shown as outstanding on the call accounts or unpaid instalment accounts in the general ledger. In addition, statements might be mailed to the subscribers following the procedure outlined for trade customers.

REFERENCES:
Montgomery, pages 530-572
Wildman, pages 178-186

Exhibit I

F. L. BARNES AND COMPANY

D. B. STORY MANUFACTURING COMPANY

CONSOLIDATED BALANCE SHEET — DECEMBER 31 1918

ASSETS

CURRENT ASSETS AND DEFERRED CHARGES:			
Cash on Hand and in Bank		$ 14,981.33	
Liberty Bonds (Less- Unpaid Installments, $5,000.00)		21,000.00	
Receivables-			
Accounts	$ 14,190.81		
Notes	1,978.09		
	$ 16,168.90		
Less- Reserve for Bad Debts	502.40		
	$ 15,666.50		
Accrued Interest	224.24	15,890.74	
Inventories - At Cost or Market whichever was the lower - as certified to by Management-			
Finished Stock	$ 75,543.82		
Work in Process	27,553.59		
Raw Materials	28,291.42		
	$131,388.83		
Less- Inventory Reserve	3,192.76	128,196.07	
Prepaid Insurance, Interest and Rent		4,599.21	$184,667.35
CASH AND SECURITIES IN HANDS OF SINKING FUND TRUSTEE FOR REDEMPTION OF FIRST MORTGAGE BONDS			20,410.77
INVESTMENT IN IMPROVED KITCHEN CABINET COMPANY (34.7% Interest) - 191 Shares of Par Value of $100.00 each, at cost			19,000.00
LAND, BUILDINGS, MACHINERY, EQUIPMENT, ETC. AT COST LESS ACCRUED DEPRECIATION:			
Buildings		$111,028.74	
Building Equipment and Fixtures		11,665.80	
Machinery		129,689.83	
Office Furniture and Fixtures		2,990.95	
		$255,375.32	
Less- Reserve for Depreciation		56,911.17	
		$198,464.15	
Land		34,250.00	232,714.15
			$456,792.27
INTANGIBLE CAPITAL:			
Goodwill			53,477.78
			$510,270.05

LIABILITIES

CURRENT LIABILITIES:			
Bank Loans		$ 75,000.00	
Trade Notes Payable		3,689.47	
Accounts Payable		19,234.62	
Accrued Wages		380.80	
Accrued Interest Payable		3,212.07	
Accrued State Taxes		2,617.54	
Accrued Federal Taxes		2,627.44	$106,761.94
FIRST MORTGAGE 6% BONDS - DUE JANUARY 1, 1927			100,000.00
Total All Liabilities			$206,761.94
MINORITY STOCKHOLDERS' INTEREST:			
50 Shares D. B. Story Manufacturing Company - Par Value		$ 5,000.00	
Proportion Surplus applicable thereto		2,389.77	7,389.77
NET WORTH:			
Capital Stock - Issued and Outstanding		$250,000.00	
Free Surplus-			
Balance January 1, 1918 (Adjusted)	$27,088.28		
Profits for year ending December 31, 1918 (After providing for Sinking Fund Reserve)	10,119.29		
	$37,207.57		
Less- Dividend paid February 1, 1918	11,500.00	25,707.57	
Appropriated Surplus - Sinking Fund Reserve		20,410.77	296,118.34
			$510,270.05

Exhibit II.

F. L. BARNES AND COMPANY

D. B. STORY MANUFACTURING COMPANY

CONSOLIDATED STATEMENT OF PROFIT AND LOSS

YEAR ENDING DECEMBER 31, 1918

Particulars		Amount
GROSS SALES		$441,817.62
Less- Discounts, Returns and Allowances		85,094.05
Net Sales		$356,723.57
LESS- COST OF SALES		262,151.52
Gross Profit from Sales		$ 94,572.05
ADD:		
Income from Restaurant	$ 308.68	
Miscellaneous Income	26.78	335.46
Gross Profit from Operations		$ 94,907.51
LESS- SELLING AND GENERAL EXPENSES:		
Magazine Advertising	$11,876.07	
Newspaper Advertising	6,178.29	
Miscellaneous Selling Expenses	6,167.08	
Officers' Salaries	16,650.00	
Office Salaries	14,447.01	
Rent	3,204.99	
Inventory Depreciation	1,558.18	
Bad Debts	702.79	
Miscellaneous General Expense	2,049.72	62,834.13
Net Profit from Operations		$ 32,073.38
LESS:		
Interest paid	$ 9,430.17	
Interest received	551.76	8,878.41
Surplus Net Profit before providing for Federal Taxes		$ 23,194.97
LESS- RESERVE FOR FEDERAL TAXES		2,627.44
Final Net Profit		$ 20,567.53
Which is Accounted for Thus:		
Minority Stockholders' Interest		$ 448.24
Provision for Sinking Fund Reserve		10,000.00
Balance - Carried to Surplus Account		10,119.29
		$ 20,567.53

Exhibit III

F. L. BARNES AND COMPANY

COMPARATIVE BALANCE SHEETS - DECEMBER 31, 1917 AND DECEMBER 31, 1918

ASSETS	December 31, 1917	December 31, 1918	Increase or Decrease*
CURRENT ASSETS:			
Cash on Hand and in Bank	$ 11,733.55	$ 14,633.83	$ 2,900.28
Liberty Bonds (Less- Unpaid Installments, $5,000.00)	$ -	$ 20,000.00	$20,000.00
Accounts and Notes Receivable-			
Accounts Receivable	$ 14,630.80	$ 10,050.22	*$ 4,580.58
Installment Accounts Receivable	3,065.42	2,003.01	* 1,062.41
Notes Receivable	1,460.02	1,978.09	518.07
	$ 19,156.24	$ 14,031.32	*$ 5,124.92
Less- Reserve for Bad Debts	1,028.90	502.40	* 526.50
Net Receivables	$ 18,127.34	$ 13,528.92	*$ 4,598.42
Accrued Interest Receivable	$ -	$ 224.24	$ 224.24
Inventories-			
Finished Goods	$ 51,898.47	$ 75,543.82	$23,645.35
Work in Process	31,640.91	27,553.59	* 4,087.32
Raw Materials	20,870.54	24,749.21	3,878.67
	$104,409.92	$127,846.62	$23,436.70
Less- Inventory Reserve	1,634.58	3,192.76	1,558.18
Net Inventories	$102,775.34	$124,653.86	$21,878.52
Prepaid Insurance, Interest and Rent	$ 3,074.80	$ 4,474.81	$ 1,400.01
Total Current Assets	$135,711.03	$177,515.66	$41,804.63
CASH AND SECURITIES IN HANDS OF SINKING FUND TRUSTEE	$ 10,000.00	$ 20,410.77	$10,410.77
INVESTMENTS IN OTHER COMPANIES:			
D. B. Story Manufacturing Company	$ 32,243.88	$ 33,036.84	$ 792.96
Improved Kitchen Cabinet Company	18,100.00	19,000.00	900.00
	$ 50,343.88	$ 52,036.84	$ 1,692.96
LAND, BUILDINGS, MACHINERY, EQUIPMENT, ETC.:			
Buildings	$ 89,722.27	$ 99,782.38	$10,060.11
Building Equipment and Fixtures	8,854.52	9,354.52	500.00
Machinery	108,951.36	110,214.08	1,262.72
Office Furniture and Fixtures	2,208.20	2,990.95	782.75
	$209,736.35	$222,341.93	$12,605.58
Less- Reserve for Depreciation	39,846.79	54,470.28	14,623.49
	$169,889.56	$167,871.65	*$ 2,017.91
Land	32,250.00	32,250.00	-
	$202,139.56	$200,121.65	*$ 2,017.91
GOOD-WILL	$ 50,000.00	$ 50,000.00	$ -
Total All Assets	$448,194.47	$500,084.92	$51,890.45

LIABILITIES	December 31, 1917	December 31, 1918	Increase or Decrease*
CURRENT LIABILITIES:			
Bank Loans	$ 62,000.00	$ 75,000.00	$13,000.00
Trade Notes Payable	2,455.80	3,689.47	1,233.67
Trade Accounts Payable	10,373.08	16,847.50	6,474.42
Accrued Interest on Bonds	3,000.00	3,000.00	-
Accrued Interest on Notes Payable	67.80	212.07	144.27
Accrued Taxes	1,954.80	2,617.54	662.74
Accrued Federal Income and Profits Taxes	1,000.00	2,600.00	1,600.00
	$ 80,851.48	$103,966.58	$23,115.10
FIRST MORTGAGE 6% BONDS	$100,000.00	$100,000.00	$ -
NET WORTH:			
Capital Stock - 250 Shares Issued and Outstanding	$230,000.00	$250,000.00	$20,000.00
Surplus-			
Balance December 31, 1917	$ 27,342.99	$ 27,088.28	*$ 254.71
Add- Profits for year ending December 31, 1918 (After providing for Sinking Fund Reserve)		10,119.29	10,119.29
	$ 27,342.99	$ 37,207.57	$ 9,864.58
Less- Dividend paid February 1, 1918	-	11,500.00	11,500.00
Balance Surplus Account	$ 27,342.99	$ 25,707.57	*$ 1,635.42
Sinking Fund Reserve	$ 10,000.00	$ 20,410.77	$10,410.77
Total Net Worth	$267,342.99	$296,118.34	$28,775.35
Total Liabilities and Net Worth	$448,194.47	$500,084.92	$51,890.45

* Red.

Exhibit IV

F. L. BARNES AND COMPANY

COMPARATIVE STATEMENT OF PROFIT AND LOSS

YEARS ENDING DECEMBER 31, 1917 AND DECEMBER 31, 1918

Particulars	1917 Amount	1917 % To Sales	1918 Amount	1918 % To Sales	Increase Or Decrease* Amount	Increase Or Decrease* % To Sales
GROSS SALES	$324,795.48	126.80	$399,403.04	127.07	$74,607.56	.27
Less- Discounts, Returns and Allowances	68,647.45	26.80	85,094.05	27.07	16,446.60	.27
Net Sales	$256,148.03	100.00	$314,308.99	100.00	$58,160.96	-
LESS- COST OF SALES (Exhibit II-a)	190,726.62	74.46	231,806.85	73.75	41,080.23	* .71
Gross Profit from Sales	$ 65,421.41	25.54	$ 82,502.14	26.25	$17,080.73	.71
ADD:						
Income from Restaurant	-	-	308.68	.10	308.68	.10
Proportion of Net Profits of D. B. Story Manufacturing Company	3,243.88	1.27	1,792.96	.57	* 1,450.92	* .70
Miscellaneous Income	-	-	26.78	.01	26.78	.01
Gross Profit from Operations	$ 68,665.29	26.81	$ 84,630.56	26.93	$15,965.27	.12
LESS- SELLING AND GENERAL EXPENSES:						
Magazine Advertising	$ 8,425.11	3.29	$ 11,876.07	3.78	$ 3,450.96	.49
Newspaper Advertising	4,973.20	1.94	6,178.29	1.97	1,205.09	.03
Miscellaneous Selling Expenses	4,012.11	1.57	4,274.29	1.36	262.18	* .21
Officers' Salaries	10,500.00	4.10	12,300.00	3.91	1,800.00	* .19
Office Salaries	8,452.00	3.30	11,247.00	3.58	2,795.00	.28
Rent	3,124.00	1.22	3,204.99	1.02	80.99	* .20
Inventory Depreciation	1,300.00	.51	1,558.18	.50	258.18	* .01
Bad Debts	542.01	.21	702.79	.22	160.78	.01
Miscellaneous General Expense	1,212.31	.47	1,651.25	.52	438.94	.05
Total Selling and General Expenses	$ 42,540.74	16.61	$ 52,992.86	16.86	$10,452.12	.25
Net Profit from Operations	$ 26,124.55	10.20	$ 31,637.70	10.07	$ 5,513.15	* .13
ADD- INTEREST RECEIVED	81.82	.03	511.76	.16	429.94	.13
	$ 26,206.37	10.23	$ 32,149.46	10.23	$ 5,943.09	-
LESS- INTEREST PAID	8,321.18	3.25	9,430.17	3.00	1,108.99	* .25
Surplus Net Profit before Federal Taxes	$ 17,885.19	6.98	$ 22,719.29	7.23	$ 4,834.10	.25
LESS- RESERVE FOR FEDERAL TAXES	1,000.00	.39	2,600.00	.83	1,600.00	.44
Surplus Net Profit	$ 16,885.19	6.59	$ 20,119.29	6.40	$ 3,234.10	* .19

* Red.

Exhibit IV - a

F. L. BARNES AND COMPANY

COMPARATIVE STATEMENT OF COST OF SALES

YEARS ENDING DECEMBER 31, 1917 AND DECEMBER 31, 1918

Particulars	1917 Amount	1917 % to Mfg. Cost	1918 Amount	1918 % to Mfg. Cost	Increase or Decrease * Amount	Increase or Decrease * % to Mfg. Cost
RAW MATERIALS	$104,258.48	51.40	$136,908.17	54.47	$32,649.69	3.07
DIRECT LABOR	$ 48,324.97	23.83	$ 62,663.80	24.93	$14,338.83	1.10
FACTORY EXPENSES:						
Depreciation	$ 14,660.60	7.23	$ 14,873.49	5.92	$ 212.89	* 1.31
Heat, Light and Power	12,567.81	6.20	12,484.90	4.96	* 82.91	* 1.24
Superintendence	8,451.89	4.17	10,129.16	4.03	1,677.27	* .14
Indirect Labor	4,556.70	2.25	4,997.08	1.99	440.38	* .26
Miscellaneous Supplies	2,347.80	1.16	3,320.18	1.32	972.38	.16
Factory Taxes	1,842.33	.91	2,413.00	.96	570.67	.05
Repairs and Upkeep - Machinery and Equipment	1,477.11	.72	1,528.75	.61	51.64	* .11
Repairs and Upkeep - Buildings	946.00	.46	332.23	.13	* 613.77	* .33
Miscellaneous Factory Expenses	3,396.13	1.67	1,714.12	.68	* 1,682.01	* .99
Total Factory Expenses	$ 50,246.37	24.77	$ 51,792.91	20.60	$ 1,546.54	* 4.17
Total Manufacturing Cost	$202,829.82	100.00	$251,364.88	100.00	$48,535.06	-
LESS- INCREASE IN INVENTORY OF WORK IN PROCESS AND FINISHED PRODUCT	12,103.20		19,558.03		7,454.83	
Cost of Finished Product Sold	$190,726.62		$231,806.85		$41,080.23	

* Red.

COMPLETE ACCOUNTING COURSE--PART II

Lecture 30

REVIEW PROBLEMS AND QUESTIONS

Question 156--

(a) State the object for which a statement showing change in financial condition is prepared.

(b) Draft two forms commonly used.

Question 157--

(a) What is a statement of charge and discharge?

(b) State the purpose for which this statement is prepared

(c) Draft same

Question 158--

(a) What is a trustee's cash account?

(b) Draft same

Question 159--Outline a method of presenting the accounts of a trustee or executor without the use of a statement of charge and discharge.

Question 160--Explain the following terms commonly used in estate accounting:

(a) Principal	(f) Legatee	(k) Apportionment
(b) Corpus	(g) Life tenant	(l) Estate
(c) Income	(h) Remainderman	(m) Trustee
(d) Testator	(i) Beneficiary	(n) Executor
(e) Intestate	(j) Advances	(o) Administrator

Question 161--

(a) Outline your conception of the distinction between principal and income as applied to estate accounting.

(b) In what way, if any, does this differ from industrial or commercial accounting?

Question 162--

(a) What is a consolidated balance sheet?

(b) What function does it perform?

(c) In what way does it differ from the ordinary balance sheet prepared for industrial and commercial concerns?

Question 163--

(a) What is a consolidating working sheet?

(b) State the purpose for which it is prepared.

(c) Draft form.

Question 164--Explain the following terms commonly used in connection with consolidated balance sheets:

(a) Holding company
(b) Subsidiary
(c) Controlling interest
(d) Minority stockholders' interest
(e) Good-will
(f) Intercompany adjustments
(g) Date of purchase

Question 165--

(a) What is your conception of an audit?
(b) Name several kinds of audits giving the distinguishing characteristics of each.
(c) State the objects to be attained by an audit.

Question 166--

(a) What do you understand by a "system of internal check"?
(b) What bearing, if any, would such systems have on the auditor's work?

Question 167--Give a brief outline of the duties of an auditor.

Question 168--At what stage of an audit should cash and negotiable securities be examined? Why?

Question 169--An audit of a set of books for the half-year ending December 31 is begun on January 26. State the procedure you would adopt to prove the correctness of the cash on hand at December 31.

Question 170--In an audit of the accounts of a firm or corporation how may the cash, as shown by the bank pass book, be reconciled with the amount called for by the cash book or ledger? After this has been done, is it necessary to check the pass book with the deposits as shown by the cash book? What might such detailed checking show?

Question 171--Give a convenient method of ascertaining whether accounts receivable are good, bad, or doubtful in a concern with 5,000 open accounts at the date of the balance sheet.

Question 172--State a method of procedure in an examination of securities consisting of bonds, stocks, and bills receivable.

Question 173--State the precautions you would take in verification requiring several days' work, of the securities of an insurance company including both stocks and bonds in negotiable and non-negotiable form.

Question 174--How would you satisfy yourself as to the existence of securities given as security for a loan to a company?

Question 175--In auditing the books of a manufacturing business that had a supposedly highly developed cost system, what steps would you take regarding inventory values that were found to agree with the cost records?

Question 176--The accounts of a steel and iron company show large additions to plant and machinery. It is found that these charges include considerable amounts from pay-rolls. In the absence of specific explanations as to pay-roll element, what method should be employed by the auditor to determine the accuracy and propriety of these charges?

Question 177--Give the procedure you would adopt in auditing cash payments, and state how to prevent the reproduction and passing of vouchers a second time.

Question 178--

(a) Under what circumstances should paid checks be treated as vouchers?
(b) Are checks proper and sufficient vouchers for purchases?

Question 179--In examining cash vouchers in the course of an audit is it necessary to place your initials or some other distinctive mark on each voucher?

Question 180--In an audit stipulating for the examination of all vouchers of every description, what would be proper vouchers for the following:

(a) Purchases
(b) Return purchases
(c) Sales
(d) Return sales
(e) Cash receipts
(f) Cash disbursements
(g) Journal entries

Question 181--How would you satisfy yourself as to whether the credits for merchandise returned are bona fide, and not made for the purpose of concealing a shortage in cash?

Question 182--In making an audit would you consider it necessary to check in detail the postings of subsidiary ledgers?

Question 183--Of what use is the minute book of a corporation to an auditor?

Question 184--Should the auditor verify the stock ledger of a corporation?

Question 185--In an audit of the accounts of a corporation should the auditor accept as conclusive the certificate of the registrar of the stock as to the total amount of capital stock outstanding?

Question 186--Is it the duty of an auditor to examine the transfer books of a company?

Question 187--Give the steps to be taken to insure the statement of the full liability on the following items appearing on the balance sheet:

(a) Preferred cumulative stock
(b) First mortgage bonds
(c) Collateral trust bonds
(d) Income bonds
(e) Car trust notes

Question 188--An auditor is engaged by a man who is buying an interest in a firm, to report upon the assets and liabilities of the firm as at a given date and upon the profits of the three years just prior. Upon the auditor's report he purchases an interest in the firm and in its assets and liabilities. Six months later it is discovered that there were bills payable due by the firm amounting to $10,000 at the time the auditor made his examination and not reported upon by him, and that these bills had continuously been due by the firm for one year prior to such examination, but no record of same had been made upon the books. Under what circumstances would the auditor be considered guilty of negligence in not discovering this fact, and under what circumstances would he be considered entirely free of any blame in the matter?

Question 189--In the statement of the earnings of a business to be sold on the basis of its earning capacity, how should the question of interest paid on accounts payable, on bills payable, and on loans be treated?

Question 190--In the case of an audit of the books of a corporation where the volume of transactions is so large that a detailed checking of postings and footings is out of the question, what course should be pursued in the examination in order to insure the correctness of the balance sheet?

Solution to Problem 62

MONTAUK MANUFACTURING CO.
STATEMENT OF AFFAIRS, JULY 2, 1919

ASSETS

Book Value				Expected To Realize
	CURRENT ASSETS:			
$ 1,402.00	Cash			$ 1,402.00
2,108.00	Bills Receivable			2,108.00
19,740.00	Accounts Receivable			18,100.00
35,800.00	Inventories			29,000.00
$ 59,050.00				$50,610.00
	CAPITAL ASSETS:			
$ 600.00	Office Fixtures			$ 500.00
7,000.00	Tools and Appliances			4,000.00
50,000.00	Machinery		$30,000.00	
	DEDUCT--Partially Secured Claim (per contra)		45,000.00	
8,000.00	Boats		$ 6,000.00	
	DEDUCT--Fully Secured Claim (per contra)		6,000.00	
4,000.00	Horses and Trucks		$ 3,000.00	
	DEDUCT--Fully Secured Claim (per contra)		3,000.00	
90,000.00	Factory Site and Buildings		$90,000.00	
	DEDUCT--(per contra)			
	Bonds	$90,000.00		
	Bond Interest	2,700.00	92,700.00	
$159,600.00				$ 4,500.00
	CONTINGENT ASSETS:			
	Notes Receivable Discounted		$ 340.00	
$218,650.00	Total All Assets			$55,110.00
	DEDUCT--Preferred Claims (per contra)			2,500.00
	Total Net Free Assets available for distribution among creditors (subject to expense of realization and liquidation)			$52,610.00
	Balance--Deficiency to Creditors			6,890.00
				59,500.00
$218,650.00	Deficiency to Stockholders (non-assessable)			$27,990.00

LIABILITIES

Gross Liabilities			Expected To Rank
	PREFERRED CREDITORS:		
$ 2,500.00	Taxes, Wages, etc.		
	(deducted per contra)	$ 2,500.00	
	FULLY SECURED CREDITORS:		
9,000.00	Chattel Mortgages	$ 9,000.00	
	(deducted per contra)	9,000.00	
	PARTIALLY SECURED CREDITORS:		
90,000.00	Bonds (Principal)	$ 90,000.00	
2,700.00	Bond Interest	2,700.00	
		$ 92,700.00	
	DEDUCT--Value of Factory Site and Buildings (per contra)	90,000.00	$ 2,700.00
45,000.00	Chattel Mortgage	$ 45,000.00	
	DEDUCT--Agreed Value of Machinery (per contra)	30,000.00	15,000.00
	UNSECURED CREDITORS:		
30,000.00	Bills Payable		30,000.00
11,460.00	Accounts Payable		11,460.00
	Discounted Notes Receivable Dishonored		340.00
	CONTINGENT LIABILITIES:		
	Notes Receivable Discounted	$ 6,660.00	
$190,660.00	Total All Liabilities		$59,500.00
$100,000.00	Capital Stock	$100,000.00	
72,010.00*	Deficit (per books)	72,010.00	27,990.00
$218,650.00			$27,990.00

* Red.

Comments on Problem 62

Deficiency to stockholders is shown at $27,990, on the theory that the stockholders' equity per books at July 2, 1919, was only $27,990 and inasmuch as the stock is non-assessable the stockholders will not lose more than their equity.

In event the stock is assessable, the deficiency to stockholders would be their equity of $27,990, plus the deficiency to creditors of $6,890 which they would be called upon to make good, or a total of $34,880.

DEFICIENCY ACCOUNT

ESTIMATED LOSS ON REALIZATION AND LIQUIDATION:			CAPITAL STOCK OUTSTANDING	$100,000
Accounts Receivable	$1,640		DEFICIENCY TO CREDITORS AS PER STATEMENT OF AFFAIRS	6,890
Inventories	6,800			
Office Fixtures	100			
Tools & Appliances	3,000			
Machinery	20,000			
Boats	2,000			
Horses & Trucks	1,000	$ 34,540		
NOTES RECEIVABLE DISCOUNTED DISHONORED		340		
DEFICIT (per books)		72,010		
		$106,890		$106,890

Solution to Problem 63

SOLUTION SUBMITTED BY
PROFESSOR JOHN R. WILDMAN IN FEBRUARY, 1913, ISSUE OF
JOURNAL OF ACCOUNTANCY

"It is probable that circle swings are sufficiently familiar to the average reader to require no description. They have sprung into existence and attained popularity within the past fifteen years. They are now an important feature of most amusement parks.

"This problem is taken from a company which was organized by the man who, it is understood, was the inventor of the circle swing, and is largely based on facts. It illustrates the ingenuity of an inventor who was an organizer and man of business ability as well as a mechanical genius.

"With a sufficiency of patents and no funds, this man, who for our purposes may be called 'Hampton' set about to organize a corporation and acquire the entire capital stock thereof in exchange for patents. The details of organization, such as the paying in of the small amount of cash required and the matter of organization expense, may be passed over, since such points have been fully discussed in previous problems and the purpose of the present problem is to bring out other points.

"With the donation by Hampton of 2,499 shares of stock we are brought face to face with the first debatable point. Presumably no one will dispute the fact that the stock, from the standpoint of the company, becomes treasury stock, since it complies with the usual interpretation of the term which holds that treasury stock is such stock as has been once issued for value and subsequently acquired. Parenthetically it may be noted that Hampton, while having provided stock which may be sold at whatever price it will bring, or if desirable, given away, has not parted with the controlling interest in the corporation. It is also apparent that his object in donating the stock was to provide what may be rather loosely termed 'working capital.'

"On the question of what account title or interpretation shall be given to the credit which arises when treasury stock is debited, authors, authorities, and novices differ. It has been variously referred to as Stock Donation account, Treasury Stock Donated, Treasury Stock Suspense, Working Capital, Capital Surplus Suspense, Surplus from Donated Stock, etc. A consideration of what it is rather than what it is called will doubtless be of some interest.

"The capital stock in the amount of $500,000 was originally issued for patents. Were the patents worth $500,000? Only future operations of plants and income derived therefrom will answer such a question. If in the judgment of the directors, this being a New York corporation, such was the value, their judgment in the absence of fraud would be conclusive. If it is conceded that $500,000 was the value of the patents, any subsequent donation of stock would affect the surplus to the extent of the value of the stock. The question of this value then becomes the second question to be settled.

"Any attempt to fix or estimate the value of the donated treasury stock would encounter ridicule. Obviously it is worth what it will bring upon sale. It is therefore apparent that some temporary disposition must be made of the credit if an account is to be set up for the treasury stock. Of the titles mentioned all are available except Surplus from Donated Stock. It should in the opinion of the author be pointed out that this is not yet surplus. It is merely a bookkeeping account set up as an expedient for holding the amount in suspense until the exact amount of the surplus arising from the donation is determined. For this purpose Stock Donation account perhaps serves as well as any other.

"In the problem under discussion, when the donated stock is received, Treasury Stock may be debited in the amount of $249,900 and Stock Donation account credited. When the 2,250 shares are sold at 90, and 225 shares given away as a bonus, Treasury Stock should be credited in the amount of $247,500 and Cash $202,500, Discount on Stock $22,500, and Stock Bonus $22,500 respectively, debited. The accounts for Discount and Stock Bonus might then, if it were desired to close the books, or set up a comprehensive balance sheet, be closed out to the Stock Donation account, the balance of which ($202,500) after bringing down an amount corresponding to the inventory of treasury stock ($2,400) could be closed out to Capital Surplus or to Profit and Loss Surplus. The former would not be available for dividends, while the latter would be. So far as the author has been able to ascertain after energetic research, there is no legal restriction upon treating such an item as profit and loss surplus. So to treat it, however, and pay it out as cash dividends would defeat the purpose of the donation. To its distribution as stock dividends there could apparently be no objection.

"Up to this point the question at issue has been presented from one point of view, that point of view being taken by those who would contend that the patents could be consistently valued at $500,000. With a view to full discussion, it should be pointed out that those who oppose this view hold that the donation of the stock is in itself evidence that the assets acquired should not be valued at the par value of the capital stock issued for them. The treatment of the accounts in this case would be the same as previously presented except that the amount previously credited ultimately to Capital Surplus or to Profit and Loss Surplus would be credited to Patents, thereby reducing the book value of the asset. This treatment it seems cannot be

consistently applied if the directors hold to the contrary through their right to fix the value, but such procedure would undoubtedly be conservative.

"Still another theory concerning the matter holds that the donation of stock is equivalent to discounting the capital stock, and such theorists would debit Discount on Stock and credit Patents in the amount of the donation. One of the earlier legal decisions in the matter holds such a transaction to be evidence of discount, or issue below par; but the courts have latterly held the contrary. If such an entry as was above noted should be made it is evident that treasury stock would not appear on the books, but that sales of the stock would be debited to Cash and credited to Discount on Stock. It is presumed that the balance of the Discount account would be written off against profits over a period of years.

"The journal entries required by the problem are as follows:

Patents		$500,000.00	
To--Capital Stock Outstanding			$500,000.00
Treasury Stock		249,900.00	
To--Stock Donation Account			249,900.00
Cash		202,500.00	
Discount on Stock		22,500.00	
Stock Bonus		22,500.00	
To--Treasury Stock			247,500.00
Stock Donation Account		247,500.00	
To--Discount on Stock			22,500.00
Stock Bonus			22,500.00
Capital Surplus			202,500.00
Cost of Swings		118,634.50	
To--Accounts Payable			73,247.92
Cash			45,386.58
Accounts Payable		50,000.00	
To--Cash			50,000.00
Privileges (1912)		12,000.00	
To--Cash			12,000.00
Cash		21,880.35	
To--Income from Swings			21,880.35
Coney Island	$12,273.85		
Atlantic City	2,863.15		
Fort George	6,743.35		
	$21,880.35		

Cash	$ 50,000.00	
To--Cost of Swings		$ 39,544.83
Profit and Loss		10,455.17
Salaries and Expenses	18,787.59	
To--Cash		18,787.59
Accounts Payable	23,247.92	
To--Cash		23,247.92
Privileges (1913)	2,000.00	
To--Cash		2,000.00
Profit and Loss	30,787.59	
To--Privileges (1912)		12,000.00
Salaries and Expenses		18,787.59
Income from Swings	21,880.35	
To--Profit and Loss		21,880.35
Profit and Loss	1,547.93	
To--Profit and Loss Surplus		1,547.93

THE HAMPTON CIRCLE SWING CO.
BALANCE SHEET, SEPTEMBER 30, 1912

ASSETS		LIABILITIES AND CAPITAL	
Equipment (cost)	$ 79,089.67	Capital Stock Outstanding	$500,000.00
Patents	500,000.00	Stock Donation Account	2,400.00
Treasury Stock	2,400.00	Capital Surplus	202,500.00
Cash	122,958.26	Profit and Loss Surplus	1,547.93
Privileges (1913)	2,000.00		
	$706,447.93		$706,447.93

ANSWERS TO QUESTIONS

Answer to Question 151--

The Net Profits of the Corporation amount to		$337,193.08
DEDUCT--Interest on Mortgage Indebtedness:		
Interest on 4% Mortgages	$20,000.00	
Interest on 6% Mortgages	45,000.00	65,000.00
Balance--Surplus Net Profits available for Dividends		$272,193.08
The proposed Dividend of 6% on Capital Stock of $5,000,000 is equivalent to		$300,000.00
DEDUCT--Surplus Net Profits for year available for Dividends		272,193.08
Balance--representing amount of Surplus at beginning of year required to be appropriated in order to pay the proposed Dividend		$ 27,806.92
The Surplus or Undivided Profits at that date amount to		$ 27,806.92

It will be seen, therefore, from the foregoing that it is necessary to appropriate all of the undivided profits or surplus at the beginning of the year in order to pay the proposed dividend.

Answer to Question 152--If a periodical provision for depreciation is not called for by the by-laws or minutes of the board of directors, it is not legally necessary to provide for depreciation of a wasting asset. Whether it is conservative business policy to do so is another question which must be decided in each case as it arises.

Where a company is organized to exploit a wasting asset and will cease to exist when its main asset is exhausted, it appears from both a legal and accounting point of view that no depreciation need be provided. In such cases the stockholders must realize that each dividend received constitutes a partial return of capital invested as well as earnings.

Where a company is organized to exploit wasting assets and new assets are to be acquired when the original ones are exhausted it appears essential, at least from an accounting point of view, to provide periodically for depreciation. If this be not done, when the original cemetery lots are sold the company will find its asset exhausted and no funds available for the acquisition of another asset. And it may be extremely difficult at that time to obtain such funds from its then stockholders who in all probability may not be the same individuals.

Answer to Question 153--Some of the closing entries in the case of a partnership are as follows:

(1)

Partners' Salaries	$--------	
To--A--Drawing Account		$--------
B--Drawing Account		--------

Partners' salaries as per partnership agreement.

(2)

Interest on Capital Accounts	--------	
To--A--Drawing Account		--------
B--Drawing Account		--------

Interest on capital accounts per partnership agreement.

(3)

All Income Accounts (detail)	--------	
To--Profit and Loss Account		--------
All Expense Accounts (detail)		--------
Partners' Salaries		--------
Interest on Capital Accounts		--------

To close balances of nominal accounts.

(4)

Profit and Loss Account	--------	
To--A--Drawing Account		--------
B--Drawing Account		--------

To close Profit and Loss account.

(5)

A--Drawing Account	--------	
B--Drawing Account	--------	
To--A--Capital Account		--------
B--Capital Account		--------

Comments

1. Entries 1 and 2 would of course only be made in the event the stipulations in the partnership agreement required that these features be dealt with.

2. It may be necessary to introduce entries in respect of proportion of commission earned on incomplete work, or preferential allowances on the business brought in by each partner.

Answer to Question 154--Assuming a complete investigation is necessary, the following will be the course of procedure:

1. The cash book should be footed and vouched in detail and certificates obtained of the opening and closing bank balances.
2. The pass book should be checked completely with the cash book, particular attention being paid to the dates when the receipts are paid in, and to ascertain that each day's receipts are included.
3. If possible, the original deposit slips from the bank should be obtained and compared with the cash book.
4. All discounts of any consequence should be tested.
5. Where a mailing department record of cash receipts has been kept, these should be compared with the cash book.
6. It should be seen that the proceeds of all notes receivable have been duly received and notes and other securities in hand should be examined.
7. As regards cash payments, special care should be taken in examining the vouchers to note any that appear to be irregular; and it is advisable that the returned checks and indorsements thereon should be examined. In the case of any vouchers being missing, duplicates should be obtained. All amounts charged to the drawing accounts of the officials and employees should be vouched by them as being correct.
8. The petty cash book should be vouched and footed, as this is a very likely source of fraud. Special attention must be paid to salaries and wages, and the accountant should ascertain that the names of all the employees, and the amounts received by them, are correct.
9. If it is possible for circulars to be sent out to the debtors, it should be done as this is the best method of confirming the validity of the outstanding balances.
10. Special attention should be paid to vouching allowances, bad debts, and returns.
11. Vouch cash sales with all evidence possible.
12. Vouch entries in audited voucher record. Duplicates should be obtained of missing invoices and the creditors' statements compared with the balances as shown by the creditors ledger.
13. Check stock certificate book.

Answer to Question 155--The directors' remuneration is commonly fixed by the by-laws and in such cases should be perused to determine the amount to be paid and whether it is payable to all directors or only to those present. If the point is not covered in the by-laws the amount to be paid and to whom it should be paid would be stipulated by a resolution adopted by the board of directors. The minute book would give the names of the directors present at each meeting.

TELEPHONE RANDOLPH 5386

ARTHUR ANDERSEN & CO

CERTIFIED PUBLIC ACCOUNTANTS

ARTHUR ANDERSEN
DAVID HIMMELBLAU

F. C. JOHNSON
RESIDENT MANAGER
W. C. REYER
PUBLIC UTILITY DEPT.
F. M. SIMONS, JR.
INDUSTRIAL ENGINEERING DEPT.

CHICAGO
NEW YORK
MILWAUKEE

HARRIS TRUST BUILDING
CHICAGO March 1, 1919.

Mr. F. L. Barnes, President,

F. L. Barnes and Company,

72 W. Adams Street,

Chicago, Ill.

Dear Sir:

As instructed, we have audited the books and accounts of F. L. Barnes and Company for the year ending December 31, 1918, and submit herewith our report thereon together with the following exhibits showing the financial position on that date and the results from operation for the year:

Consolidated Balance Sheet - F. L. Barnes and Company and D. B. Story Manufacturing Company at December 31, 1918	Exhibit I
Consolidated Statement of Profit and Loss - F. L. Barnes and Company and D. B. Story Manufacturing Company for year ending December 31, 1918	Exhibit II
Comparative Balance Sheets - F. L. Barnes and Company at December 31, 1917, and December 31, 1918	Exhibit III
Comparative Statements of Profit and Loss - F. L. Barnes and Company years ending December 31, 1917, and December 31, 1918	Exhibit IV
Comparative Statements of Cost of Sales - F. L. Barnes and Company years ending December 31, 1917, and December 31, 1918	Exhibit IV-a
Adjusting Journal Entries necessary to bring books into accord with auditor's report	Exhibit V

PROFITS FROM OPERATION

The results from operations of F. L. Barnes and Company for the years 1917 and 1918 are shown in the following condensed summary:

Particulars	Year Ending December 31 1917	Year Ending December 31 1918	Increase or Decrease *
Net Proceeds from Sales	$256,148.03	$314,308.99	$58,160.96
Factory Cost of Goods Sold	190,726.62	231,806.85	41,080.23
Gross Profit on Sales	$ 65,421.41	$ 82,502.14	$17,080.73
% to Sales	25.54	26.25	.71
Add- Miscellaneous Income	3,243.88	2,128.42	1,115.46
Total Income and Profits from all sources	$ 68,665.29	$ 84,630.56	$15,965.27
% to Sales	26.81	26.93	.12
Selling and General Expenses	42,540.74	52,992.86	10,452.12
% to Sales	16.61	16.86	.25
Net Profit from Operations	$ 26,124.55	$ 31,637.70	$ 5,513.15
% to Sales	10.20	10.07	* .13
Deduct-			
Interest on Borrowed Money	$ 8,321.18	$ 9,430.17	$ 1,108.99
Interest Received	81.82	511.76	429.94
	$ 8,239.36	$ 8,918.41	$ 679.05
Surplus Net Profits before Federal Taxes	$ 17,885.19	$ 22,719.29	$ 4,834.10
Deduct- Estimated Federal Taxes	1,000.00	2,600.00	1,600.00
Final Net Profits	$ 16,885.19	$ 20,119.29	$ 3,234.10

The Final Profits of $20,119.29 for 1918 are accounted for as follows:

1st Mortgage Bonds Sinking Fund Reserve	$10,000.00
Free Surplus	10,119.29
As above	$20,119.29

* Red.

From the above, the causes of the increase of $3,234.10 in Final Net Profits may be set forth as follows:

Increase in Gross Profits due to Increase in Sales (25.54% of $58,160.96)		$14,854.58
Increase in Gross Profits due to Decrease in Cost of Sales (.71% of $314,308.99)		2,226.15
Total Increase in Gross Profits from Sales		$17,080.73
Decrease in Profits of D. B. Story Manufacturing Company	$1,450.92	
Less- Increase in Miscellaneous Income	335.46	1,115.46
Net Increase in Total Income and Profits		$15,965.27
Less-		
Increase in Advertising and Other Selling Expenses	$4,918.23	
Increase in General Expenses	5,533.89	10,452.12
Increase in Net Profits from Operations		$ 5,513.15
Increase in Interest Paid	$1,108.99	
Less- Increase in Interest Received	429.94	
	$ 679.05	
Increase in Provision for Federal Taxes	1,600.00	2,279.05
Net Increase in Final Net Profits		$ 3,234.10

The volume of sales has increased materially during the year, as may be seen from the following table:

	1917		1918		Increase or Decrease*	
Style	Number	Amount†	Number	Amount†	Number	Amount†
180	17	$ 937.00	7	$ 366.00	*10	*$ 571.00
181	778	48,072.19	1,176	72,523.31	398	24,451.12
183	800	60,749.12	881	66,545.46	81	5,796.34
185	1,139	98,498.33	1,302	111,606.06	163	13,107.73
187	447	42,988.81	624	59,439.05	177	16,450.24
Specials	42	3,343.02	51	4,251.41	9	908.39
Miscellaneous	-	3,132.76	-	738.70	-	*2,394.06
Total	3,223	$257,721.23	4,041	$315,469.99	818	$57,748.76
Less- Returns and Allowances.	-	1,573.20	-	1,161.00	-	* 412.20
Net Sales	3,223	$256,148.03	4,041	$314,308.99	818	$58,160.96

* Red.

† After deducting discounts Improved Kitchen Cabinet Company.

In connection with Exhibit IV-a which compares the cost of sales for the years 1917 and 1918 we desire to call your attention to the following points:

(1) Increased production has not materially increased factory overhead. Heat, Light and Power has even decreased, owing to the purchase of a cheaper grade of coal.

(2) The ratio of factory overhead to direct labor was 103.98% in 1917 as compared with 82.65% in 1918. This is explained by the fact that, although materials and direct labor both increased approximately 30% in 1918 as compared with 1917, factory expenses increased but 3%.

(3) The amount of factory overhead in work in process and finished stock was determined in the inventory of December 31, 1918 by applying the ratio of total factory expenses for the year to total direct labor for the year. This ratio was 82.45%, the small difference resulting when compared with the percentages appearing in (2) being caused by minor adjustments in the accounts after computing the latter.

(4) The increase in gross profits attributable to the proportionate decrease in cost of sales is $2,226.15, as shown in the above profit and loss analysis.

The increase in selling and general expenses is due principally to the increase in both newspaper and magazine advertising, and to the increase in officers and office salaries. It may be added, however, that in view of increased sales the increases in these items are normal.

A consolidated income statement will be found in Exhibit II.

BALANCE SHEET

A consolidated balance sheet appears in Exhibit I showing the combined financial strength of F. L. Barnes and Company and its subsidiary, the D. B. Story Manufacturing Company, at December 31, 1918. However, as the financial policies of the two companies are quite separate - there having been no intercompany transactions during the year 1918 - our remarks are here confined to the balance sheet of F. L. Barnes and Company appearing in comparative form in Exhibit III.

CASH ON HAND AND IN BANK - $14,633.83:

We reconciled the book balances of cash in bank with the balance certified to by the bank. Petty cash of $500.00 was verified and traced back satisfactorily to December 31, 1918.

LIBERTY BONDS - $20,000.00:

There are $15,000.00 of the Third Issue on hand fully paid for and subscription receipts for $10,000.00 of the Fourth Loan one-half of which has been paid. The remaining instalments of $2,500.00 each were paid on January 16 and January 30, 1919 respectively.

ACCOUNTS AND NOTES RECEIVABLE - $14,031.32
RESERVE FOR BAD DEBTS - 502.40:

We carefully examined the outstanding acoounts and notes, and the reserve, we believe, is ample to cover any losses from uncollectible accounts.

It will be of interest to note that the accounts receivable of $10,050.22 were charged as follows:

September 1918	$ 12.55
October	513.45
November	1,768.12
December	7,756.10
	$10,050.22

INVENTORIES - $127,846.62
LESS- RESERVE FOR LOSS ON INVENTORIES - 3,192.76:

We made thorough checks on extensions, footings and pricings and are pleased to state that we found the inventory well taken and carefully handled throughout. On the principle of cost or market, which is the lower, we provided small additions to the inventory reserve, one to reduce the cost of lumber purchased to market (see Adjusting Journal Entry 3) and another to provide for losses on sales of obsolescent styles (see Adjusting Journal Entry 4).

All other goods on hand are of recent purchase and manufacture and represent saleable stock. Responsible officials have certified to the

correctness of the inventory (a) taken by actual count, weight and measure, (b) condition of stock, and (c) valuation.

INVESTMENTS IN-
D. B. STORY MANUFACTURING COMPANY - $33,036.84
IMPROVED KITCHEN CABINET COMPANY - 19,000.00:

The first of these accounts is made up as follows:

Jan. 1, 1917	200 Shares (out of a total outstanding of 250) at 150		$30,000.00
Dec. 31, 1917	Four-fifths of 1917 Profits		3,243.88
Dec. 31, 1918	Four-fifths of 1918 Profits		1,792.96
			$35,036.84
Less- Dividends received as follows:			
July 1, 1917	Cash Dividend	$1,000.00	
July 1, 1918	Cash Dividend	1,000.00	2,000.00
	Balance December 31, 1918		$33,036.84

The investment in the Improved Kitchen Cabinet Company (a selling organization) represents the total cost of 191 shares out of a total issued and outstanding of 500 shares. No dividends have as yet been declared by this company.

CASH AND SECURITIES IN HANDS OF
SINKING FUND TRUSTEE - $20,410.77:

A statement was obtained from the Atlas Trust Company, trustee under the trust indenture, certifying that the following was in their possession on December 31, 1918:

Cash	$10,316.77
Liberty Bonds- 1st Issue (par $10,300.00)	10,094.00
	$20,410.77

The trust deed provides that at the close of each calendar year the company shall turn over to the Sinking Fund Trustee the sum of $10,000.00 in cash which may be invested by the Trustee at his discretion in Government Bonds only.

We satisfied ourselves that these and other provisions of the trust indenture have been fully complied with.

LAND, BUILDINGS, MACHINERY, EQUIPMENT
AND FIXTURES - $254,591.93
LESS- RESERVE FOR DEPRECIATION - 54,470.28:

The changes that have taken place in the Capital Asset Accounts during the year 1918 may be summarized as follows:

Account	Balance Jan. 1 1918	Additions During Year	Balance Dec.31 1918	Reserve for Depreciation	Book Value Dec.31 1918
Buildings	$ 89,722.27	$10,060.11	$ 99,782.38	$10,640.54	$ 89,141.84
Building Equipment	8,854.52	500.00	9,354.52	3,789.35	5,565.17
Machinery	108,951.36	1,262.72	110,214.08	39,234.15	70,979.93
Office Furniture and Fixtures	2,208.20	782.75	2,990.95	806.24	2,184.71
Land	32,250.00	-	32,250.00	-	32,250.00
Total	$241,986.35	$12,605.58	$254,591.93	$54,470.28	$200,121.65

We examined the vouchers supporting the purchase of these assets and in our opinion they have been correctly charged at cost to the above accounts. Depreciation has been computed on the basis of 3% for buildings, 10% for building equipment and machinery, and 15% for office furniture and fixtures. It will be noted that the larger part of the machinery taken over from F. L. Barnes and Sons was valued at a depreciated figure which was said to average approximately 90% of the original cost, and that the actual depreciation rate on this basis is only 9%.

Depreciation was provided for during 1918 as follows:

Asset	Rate	Amount
Buildings	3%	$ 2,691.67
Building Equipment	10%	885.45
Machinery	10%	10,965.14
Office Equipment	15%	331.23
Total Provision		$14,873.49

In our opinion the rates and the amounts so far provided are adequate.

CURRENT LIABILITIES - $103,966.58:

So far as we were able to ascertain all liabilities at December 31, 1918 have been given expression to on the books of account on that date and in the attached exhibits.

CAPITAL STOCK - $250,000.00:

Unissued stock was sold during the year at par amounting to $20,000.00. There were no transfers in 1918.

The book values per share at December 31, 1917 and December 31, 1918 were:

Particulars	December 31 1917	December 31 1918
Capital Stock	$230,000.00	$250,000.00
Surplus	27,342.99	25,707.57
Sinking Fund Reserve - 1st Mortgage Bonds	10,000.00	20,410.77
Total Book Value	$267,342.99	$296,118.34
Book Value per share	$116.24	$118.45

CHANGE IN FINANCIAL POSITION

A summary of the funds received and applied during 1918 appears below:

Funds were derived from the following sources-		
Sale of Capital Stock - 200 shares at par		$20,000.00
Income from Operations including provision for accrued depreciation-		
Final Net Profits	$20,119.29	
Additions to Reserve for Depreciation	14,623.49	
Dividend from D. B. Story Manufacturing Company	1,000.00	
	$35,742.78	
Less- Book write-up covering profits of D. B. Story Manufacturing Company	1,792.96	33,949.82
Total Funds Provided		$53,949.82

Which were applied in the following manner:

Additional investment in Buildings, Machinery and Equipment	$12,605.58
Additional Sinking Fund Deposit	10,000.00
Dividends paid	11,500.00
Purchase of additional stock in Improved Kitchen Cabinet Company	900.00
Payment of 1917 Income Tax in excess of provision therefor	254.71
Net Increase in Working Capital as summarized below	18,689.53
Total (as above)	$53,949.82

SUMMARY OF INCREASES AND DECREASES IN WORKING CAPITAL

	December 31			
Current Assets	1917	1918	Increase	Decrease
Cash	$ 11,733.55	$ 14,633.83	$ 2,900.28	$ -
Notes and Accounts Receivable (net)	18,127.34	13,753.16	-	4,374.18
Liberty Bonds	-	20,000.00	20,000.00	-
Inventories (net)	102,775.34	124,653.86	21,878.52	-
Prepaid Expenses	3,074.80	4,474.81	1,400.01	-
Total Current Assets	$135,711.03	$177,515.66	$41,804.63	$ -
Less- Current Liabilities	80,851.48	103,966.58	23,115.10	-
Net Increase as above	$ 54,859.55	$ 73,549.08	$18,689.53	$ -

It will be noted that although working capital has actually increased during the year $18,689.53, the ratio of current assets to current liabilities has remained practically constant (1.68 to 1 in 1917 as compared with 1.70 to 1 in 1918). Our examination of purchase discounts taken and not taken leads us to the conclusion that if this ratio were 2.5 or 3 to 1 the purchase discounts for the year could have been more than doubled. The problem of whether or not an additional investment of $40,000.00 or $50,000.00 should be made for working capital purposes should be given careful study.

GENERAL

During the course of our audit we examined in detail the cash receipts and disbursements for the months of April and December 1918; tested the distribution as shown on the supporting vouchers; footed the cash book and traced the totals into the general ledger; checked over the sales invoices during the same two months, including the posting to customers' accounts; and by these and other checks we satisfied ourselves that the books had been properly kept. We also examined the minutes of the Directors and Stockholders meetings and satisfied ourselves that all action taken at these meetings affecting the accounts has been properly recorded on the books of the company.

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In conclusion we wish to acknowledge the courtesies rendered our representatives during the audit.

Very truly yours,

Arthur Andersen & Co

Certified Public Accountants.

Exhibit V

F. L. BARNES AND COMPANY

ADJUSTING JOURNAL ENTRIES

TO BRING BOOKS INTO CONFORMITY WITH REPORT

(1)

OFFICE FURNITURE AND FIXTURES P/C VOU. #1561	$ 78.80	
MISCELLANEOUS RESTAURANT EXPENSE P/C VOU. #1543	17.50	
FACTORY HEAT, LIGHT AND POWER P/C VOU. #1580	56.00	
OFFICE REPAIRS P/C VOU. #1575	64.13	
ADVERTISING - NEWSPAPERS P/C VOU. #1581	281.18	
To ACCOUNTS PAYABLE		$ 497.61

November and December 1918 invoices paid in January 1919.

(2)

CASH IN BANK	26.78	
To PROFIT AND LOSS 1918		26.78

1915 and 1916 Payroll checks written off.

(3)

PROFIT AND LOSS 1918	942.28	
To INVENTORY RESERVE		942.28

Markdown in the following accounts-

Account	Cost	Market	Difference
Lumber (Yard)	$11,584.29	$10,758.28	$826.01
Lumber (Factory)	1,028.96	1,001.19	27.77
Lumber (Kiln)	2,147.18	2,058.68	88.50
	$14,760.43	$13,818.15	$942.28

(4)

PROFIT AND LOSS 1918	615.90	
To INVENTORY RESERVE		615.90

Markdowns in Inventory of Work in Process to give expression to additional cost of

Job Ticket	Style	Est. Cost	Avg. Cost	Markdown
18,341	187	$5,287.12	$4,875.00	$412.12
18,349	180	653.78	450.00	203.78

(5)

RETURNS AND ALLOWANCES	$ 264.00	
BAD DEBTS	702.79	
To ACCOUNTS RECEIVABLE		$ 773.00
INSTALMENT ACCOUNTS RECEIVABLE		193.79

Uncollectible Accounts Receivable as per lists thereof.

(6)

PROFIT AND LOSS	100.00	
To INVESTMENT IN IMPROVED KITCHEN CABINET COMPANY		100.00

10 shares stock purchased July 1, 1918 at 90;; Investment was charged at par and Profit and Loss credited; this entry to reduce investment to cost.

(7)

BUILDINGS	200.00	
To OFFICERS' SALARIES		200.00

To adjust salary of H. E. Barnes for the month of July 1918, 1/2 of his time being devoted to the construction of Building O.

(8)

BUILDINGS	1,264.67	
To BUILDING EQUIPMENT AND FIXTURES		1,264.67

Transfer of cost of skylights installed in 1918 to Buildings Account.

(9)

BUILDING EQUIPMENT AND FIXTURES	500.00	
To REPAIRS AND UPKEEP - BUILDINGS		500.00

Cost of 2 Johnson heating furnaces charged to Repairs in error.

(10)

PROFIT AND LOSS	70.00	
RESERVE FOR DEPRECIATION - MACHINERY	180.00	
SALES	350.00	
To MACHINERY		600.00

Lathe scrapped during year and proceeds credited to sales.

(11)

INTEREST PAID	$ 212.07	
To ACCRUED INTEREST ON NOTES PAYABLE		$ 212.07

Interest on Bank Loans and Trade Notes at December 31, 1918.

(12)

INTEREST PAID	3,000.00	
To INTEREST ACCRUED ON BONDS		3,000.00

Interest Accrued from July 1, 1918 to December 31, 1918.

(13)

ACCRUED INTEREST RECEIVABLEA	224.24	
To INTEREST RECEIVED		224.24

Interest Accrued as follows:

Notes Receivable	$ 35.61
Liberty Bonds	188.63
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(14)

FEDERAL INCOME TAX	2,600.00	
To FEDERAL TAXES ACCRUED		2,600.00

Estimated Income and Profits Taxes for 1918.